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Interim Hearing on Moving Toward Greater Competition: Pending Regulatory Changes of Our Local Telephone Network

Senate Committee on Energy and Public Utilities

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CALIFORNIA LEGISLATURE
SENATE COMMITTEE ON
ENERGY AND PUBLIC UTILITIES
SENATOR HERSCHEL ROSENTHAL, CHAIRMAN

Interim Hearing on
**MOVING TOWARD
GREATER COMPETITION:
PENDING REGULATORY CHANGES OF
OUR LOCAL TELEPHONE NETWORK**



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October 25, 1988
State Building Auditorium, Room 1138
107 South Broadway
Los Angeles, California

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Paul L. Fadelli
Michael E. Shapiro
Committee Secretary
Patricia J. Stearns

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Senator Herschel Rosenthal, Chairman

Interim Hearing on

MOVING TOWARD GREATER COMPETITION:

PENDING REGULATORY CHANGES OF OUR LOCAL TELEPHONE NETWORK



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ALFRED E. ALQUIST
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SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

HERSCHEL ROSENTHAL
CHAIRMAN

PAUL L. FADELL
PRINCIPAL CONSULTANT

MICHAEL E. SHAPIRO
SENIOR CONSULTANT

PATRICIA J. STEARNS
COMMITTEE SECRETARY

ROOM 2035, STATE CAPITOL
SACRAMENTO, CA 95814
TELEPHONE: 445-9764

INTERIM HEARING AGENDA

Tuesday, October 25, 1988, 9 am to 5 pm
State Building Auditorium, Room 1138
107 South Broadway, Los Angeles, California

"MOVING TOWARD GREATER COMPETITION: PENDING REGULATORY CHANGES OF OUR LOCAL TELEPHONE NETWORK"

WITNESSES

PANEL I PUBLIC UTILITIES COMMISSION

G. Mitchell Wilk
Commissioner
Public Utilities Commission

William Thompson
Project Manager
Division of Ratepayer
Advocates, PUC

PANEL II LOCAL TELEPHONE UTILITIES

Bruce Jamison
Executive Director
Regulatory
Pacific Bell

Timothy J. McCallion
Director, External Affairs
GTE California

Barry A. Ross
Executive Vice President
California Telephone Association

PANEL III CONSUMERS/COMPETITORS

Sylvia M. Siegel
Executive Director
Toward Utility Rate
Normalization (TURN)

Michael Morris
Vice President
California Cable
Television Association

Ken McEldowney
Executive Director
Consumer Action

John R. Ayers
President
Bay Area Teleport

John P. McDonald
Vice President and
Associate General Counsel
Reuben H. Donnelley, a
company of the Dun & Bradstreet Corp

LUNCH BREAK

PANEL IV

LONG DISTANCE TELEPHONE

Bob Stechert
Vice President
Regulatory Affairs
AT&T

Mary Wand
Director, Regulatory
Pacific Division
MCI

Ann Pongracz
Director, External Affairs
US Sprint

Richard Frockt
TMC Communications
President, CalTel

OPEN MICROPHONE

For brief identification and short summary of positions not already reflected by witnesses on the panels.

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California Legislature

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APPENDICES

Senate Energy & Public Utilities Committee
Memorandum to Members in connection with this hearing

GTE California
Joint Audit Report - Summary

Consumers Coalition of California
Joint Audit Report - Summary

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SENATOR HERSCHEL ROSENTHAL, CHAIRMAN: Good morning! Thank you for joining us at the hearing today. I want to welcome the witnesses, spectators, and other legislators to what will be the third hearing by this committee in as many years on how competition may impact our state's telephone networks. Chairwoman Gwen Moore, of the Assembly Utilities and Commerce Committee, will also be joining us and help oversee what I believe to be the most important undertaking by the PUC involving changing how we may use and pay for telephone service in California.

The divestiture of AT&T in 1984, and rapidly changing technology has forced states to deal dramatically with different regulatory environments of the local telephone service.

And, while we continue to hear that other states have: (1) moved quickly to change the way they regulate telephone utilities and (2) have moved quickly to set utilities free from the "Boogie man" of regulation--it is logical that California should take a more studious course--because; first, California is dramatically more complex than other states; second, California has the most lucrative telecommunications markets in the nation; and third, California telephone ratepayers have, under this supposedly archaic regulatory system, maintained high quality telephone service at relatively reasonable rates.

And this is why this PUC undertaking is so important to all of us. We are in the process of dramatically changing something which has worked fairly well up until now. So, I think the stakes are enormous.

The Legislature has tried to be an amiable partner in working through the process of change--not dictate the policy, but trying to assist the Commission's investigation. However, all I continue to hear from various parties is that the process is truncated, is moving far too fast, and won't be able to accommodate all the views that want to be expressed. I haven't heard these complaints, however, from Pacific Bell.

I personally tried to assist the process and parties to this massive investigation by introducing two bills: The first, would have required a report to the Legislature on the regulatory changes proposed by the PUC. Also, in order to allow the Legislature and the public an additional review period without changing Commission decisions, Senate Bill 680 would have simply

required 30 additional days of public review before the decisions would go into effect. With no opposition other than the PUC, this bill was vetoed by the Governor.

With so much riding on what is or is not considered to be "competitive," the second bill would have simply required the PUC to explain to us how they determined what "competitive" means. With the opposition of the PUC and the telephone utilities this bill failed in Committee.

So, this hearing is really another attempt to say that the Legislature cares, that it has a role in deciding the future of telephone service for users in the State, who also happen to be constituents. We don't want to determine or lay the groundwork for those regulatory changes--that's the Commission's job. But our job is to assure that the Commission gets the widest spectrum of views before these important decisions are made--and that the process will be fair. Then, if we don't like what the PUC's decided, of course we can begin a journey through the legislative process.

You know--from all that I've heard, from newspaper clippings and telephone billing inserts, I am aware that Pacific Bell has a proposal of "rate flexibility", and that it would like to see it implemented as soon as possible. Some of those proposals are very good and interesting, others may not be. But, I am hopeful that this hearing will demonstrate--without prejudice to the--Pac-Bell proposals--that there are other proposals, other ideas, and other viewpoints which warrant similar attention.

We will hear first from the assigned PUC Commissioner of this investigation, Mitchell Wilk and then from the project manager for the division of Ratepayer Advocates who is responsible for a report on Phase II of the investigation, William Thompson.

Then, we will move to the telephone utility panel and the consumer/competitor panel, and after the lunch break, we will hear from the long distance carriers.

Commissioner Wilk, I understand that you'll be required to leave early, and we will understand when you do that. If you will begin please--we are ready.

MR. G. MITCHELL WILK: Thank you very much Mr. Chairman, it's a pleasure to be here. As I said if it's Tuesday it must be L.A. I'd like to thank you for the opportunity to appear before you today to discuss the progress in the Commission's investigation into the regulation of local telephone companies.

As you know we've completed the first phase of our proceeding and are now on our way into hearings for Phase II. I would like to recount a few details about the Phase I decision before turning to some of the issues we

will be addressing shortly.

The Commission decided to accept the settlement that most parties agreed to in Phase I. As a result there will be downward only pricing flexibility for local telephone companies for centrex, highspeed private line and vertical services. Long distance companies and others will now be able to enter the intraLATA market for highspeed private line and provide competitive alternatives for customers. We are now receiving the implementation filings that will be needed to start this process and we hope to see some price reductions shortly. This decision furthers the public interest in several respects. First, the pricing flexibility is downward only. Customers can't lose. And they may, in fact, receive lower prices. By these services, these are services that both residential and business consumers buy. Second, this flexibility may help local telephone companies keep customers that they might otherwise lose and this will increase the availability of contribution to margin and keep everybody's rates down. Thirdly, the new competitive alternatives in private lines should continue to improve quality and service in that market as customers get more choices. Finally, the economy generally should benefit from better and cheaper telephone services. While these services and benefits are difficult to measure they should show up in such ways, as lower consumer prices, more options, and more product innovation.

With Phase I in place, we turn to Phase II. Here, one can refine the entire proceeding into one key question, "How can we best set rates for the remaining monopoly services in this mixed monopoly competitive environment?" As you are probably aware, and will hear today, there is a broad range of alternatives out there. I should emphasize that neither I, nor my colleagues have made up our minds obviously regarding exactly what form and what alternative will work best, although, I think we all agree with a near unanimous view of the parties that change is desirable and necessary.

Well, I can't tell you exactly what will emerge, let me focus for a minute on some desirable characteristics that I'll be looking for. First, we must have an alternative that makes ratepayers of all types at least as well off as they are likely to be under our current regulation. Otherwise, it would hardly seem worthwhile to change. We think that these extra benefits can be found if local telephone companies can be given better incentives to cut costs, become innovative and offer customers the services and choices they want most. We also want to get ratepayers out of the position of making financial guarantees for risky new ventures, a situation that is nearly unavoidable under our current regulation of this increasingly competitive enviro-

ment. Finally, we want a workable process that is understandable to the public and that produces tangible results in a reasonable time. While our process has been passing through some of the efficiency, passing through some of the efficiencies of new technology to ratepayers, it has done so through a costly system fraught with Archaean procedures and unacceptable delay and uncertainty.

Let me conclude these opening remarks with a few words about procedure. We have, and I presume that the Members of this Committee have also been hearing a great deal from some of the parties about the scheduling of this proceeding.

We hear that our objective of a Phase II decision in the first quarter of next year is unfair or unrealistic and I'd like to offer some perspective on this. First, one of the most widely heard complaints about the PUC is the palatial pace at which it does its business. After nearly two years on the Commission I can tell you that it's all true. I have seen few governmental agencies that are as capable as we are of taking relatively simple matters and dragging them out over several months or years. Now I recognize that issues such as those in the OII require careful study and a full opportunity for all interested parties to participate. However, it is apparent that the typical approach to most problems is a slow one where no one seems to think that delay matters very much. Frankly, it is one of my goals as a Commissioner to change that attitude, and there are a number of ways of going about it.

My approach is set a tight but realistic schedule for our proceedings at the outset. And to encourage parties to make their best efforts to meet it. If we get to a point where it is apparent that more time is really needed, I will grant it, and I have done so. I am certainly a realist about this. However, this Commission is going to maintain control over its own agenda.

There is also some apparent confusion about the difference between a decision and a full implementation of the results. When I talk about the decision in the first quarter of 1989, I recognize that certain follow-up activities will probably be needed to make a regulatory alternative fully operational. For example, our CACD staff will have to review cost data from the local telephone companies before the price floors established in Phase I can be instituted for pricing flexibility. I've heard that some parties interpret our goal for a Phase II decision as foreclosing those options that might require some follow-up for full implementation just as the cost reviews are needed to make Phase I effective. That's simply not true. While it would be nice to have the entire approach in place at that time, our goal relates to a decision. No one's proposal will be prejudiced if it includes some of the implementation activities after the policy decision. Finally, I'd like to

announce today, that we will be granting some extra hearing time in response to the request that DRA and others have made. I am still working with A.L.J. Ford to determine just how much is needed, but we agree with parties that the hearings should, in fact, be expanded. I will issue an assigned Commissioner's ruling very shortly, perhaps this week or next, detailing these changes in expanding the hearing time. I should note that while it may have been a coincidence that I appear today with DRA at my side, from my prior remarks it is clear that all of us, including you, are sensitive to perception. Let me clarify that while DRA and I share this panel, no one should conclude that DRA's recent proposal in Phase II of our proceeding represents a formal or informal Commission view or direction. As you well know DRA's is an independent advocacy division who's recommendations, like all others, must be subject to the rigors of our proceeding and will ultimately stand or fall on its own merits.

Once again, I'd like to thank the Chairman for inviting me to appear today and on behalf of my colleagues we welcome the opportunity to work closely with the Committee and we will continue to value your insightful assistance and advice.

I would be happy to answer any questions you might have. My advisor, Carl Danner, is here also and will be here all day to help answer any concerns or questions you might have. Thank you.

SENATOR ROSENTHAL: You know, it appears to be kind of interesting that it takes a hearing to give you an opportunity to say that there will be more time because, maybe people have questions and problems, and that kind of bothers me a little bit, Mr. Commissioner. You could have put those concerns to rest when, after the scheduling of Phase II, you could have made it obvious that it would have not been continuing faster, in terms of giving people due process and more time or whatever was necessary. The impression is that you say that nothing is being rushed but we continue to hear those concerns. And I'm pleased to hear that, your statement now, that there will be sufficient time for people to respond.

MR. WILK: Mr. Chairman, can I just make one observation of that?

SENATOR ROSENTHAL: Yes.

MR. WILK: We, regardless of the hearing time today, we obviously heard the same complaints you did. And it was only last week that, frankly, I became convinced, just because of the numbers, in fact everybody but Pac-Bell as you correctly observed was complaining about the time. So, it is purely coincidental that the decision to expand the time frame would coincide with these hearings. It doesn't take a hearing to reach, frankly, a common sense conclusion.

SENATOR ROSENTHAL: O.K. Let me ask you another question. After the settlement of Phase I, in which it appears that everybody had signed off, we've been hearing that there have been objections raised because there were changes made in Phase I which were not part of the original agreement. Do you want to comment on that?

MR. WILK: Yes, I think that that question Mr. Chairman refers to the fact that we, we had to for legal reasons revise the settlement in what we considered to be fairly benign policy neutral ways, because of legal, what we, what we very strongly believed in our, we were told by our attorneys, could have created a legal basis for rehearing. And to the extent that we saw that there was a need to revise that, revise that Phase I settlement, to accommodate what we thought, and of course as you may well know lawyers can disagree, but our attorneys felt that we needed to clarify some very important legal distinctions in the final Phase I settlement.

SENATOR ROSENTHAL: You know, usually in billing inserts we identify for customers what has changed. I call your attention to one which says, "These are the regulations which may come about," which kind of gives an indication that something really is going..that that's what's going to happen. Because only PacBell and General proposals, not the Commission decisions, appeared in that. Does that bother you at all?

MR. WILK: Well, we want to--I think this is all kind of..

SENATOR ROSENTHAL: More confusion?

MR. WILK: Well, it might be more confusion, but on the other hand I think that there is an equally persuasive argument that, that, perhaps it's time that we prepare people for the fact that change is likely. Where that change goes, what specifics will be included in that change, obviously, are yet to be concluded. But we thought, and I still think, it is to the enlightened self interests to the consumers of this State, residential, consumer and otherwise, that commercial and otherwise, that, that in fact, we need to alert them to the, to the, to the possibility of change and to encourage them to be in the process, Senator. This is something that, you know, I've shared with you on a number of occasions. We want to encourage people to participate in our process. I think we would have been far more susceptible to criticisms had we not encouraged the local exchange companies to alert their consumers to the fact that these proceedings are underway.

SENATOR ROSENTHAL: Just, just--It kind of looks like a fait accompli. You know, it just, it looks like this is what's ahead in 1988, and yet it may not be. You may have created more confusion.

MR. WILK: Senator,...

SENATOR ROSENTHAL: You may have created more confusion, may have contributed more confusion than would have happened if something had come out after you made the decision which said it's going to take place in sixty days.

MR. WILK: Well, again, I guess that it depends upon how you, how you view the desirability of alerting the consumers, telecommunication consumers of this State, the fact that there is a major proceeding underway that could affect them and to encourage them to participate in the process. It was certainly no one's intent to suggest that fait accompli in any telephone company that suggests for a moment that their proposals of fait accompli has got a surprise coming.

SENATOR ROSENTHAL: Just last week the PUC announced another investigation into PacBell's request for greater leeway in providing enhanced services. Isn't this also an ambitious proposal...with what is already on your agenda?

MR. WILK: Senator, I'm not sure I follow the question.

SENATOR ROSENTHAL: Well, "PUC begins review of Pacific Bell's proposal for new enhanced telephone services." (Holds up press clipping)

MR. WILK: Hmmhuh.

SENATOR ROSENTHAL: OK? Shouldn't this wait until after you have this...

MR. WILK: No, I think the availability of new and enhanced services is something that we should be considering on an ongoing basis. The question before us today, Senator, and this investigation, is how do we regulate the monopoly, how do we, how do we determine the future? Why jeopardize the availability of new services that the consumers, both residential and commercial, may wish to have. I don't see that that needs to be held up. In fact, and correct me if I'm wrong--Carl maybe you can, you can clarify this, but I'm told that the FCC this past summer, frankly, allowed all the regional Bell operating companies to do exactly this without getting regulatory approval. And PacBell on its own came to us saying the we're not going to do anything without your approval. So in a way, they went beyond what was necessary. I think that's--yeah I think that's accurate. So, there's no reason to stop the development and the, and the availability of new services and new products simply because we have the investigation going on. However, if I might just expand on the answer, if we find that there are questions involved in, for example, the deployment of these services that are very closely intertwined with the proceeding, then, yes, we would, we would certainly I think consider

holding them out for that.

SENATOR ROSENTHAL: Well, we've also heard that you have a shortage of staff. That they're busy doing all kinds of things--do you have enough staff for this kind of thing?

MR. WILK: As far as I know, I don't...

SENATOR ROSENTHAL: Staff, for staff, right?

MR. WILK: Well, you know I feel we've got plenty of staff, Mr. Chairman.

SENATOR ROSENTHAL: You originally announced, Commissioner, that Phase III of the investigation would investigate whether or not competition should be allowed within the local service areas. Has the announcement by Pacific Bell to allow competition within the LATA changed the dynamics of your investigation? I'm told you would like to relinquish that issue in Phase II.

MR. WILK: In fact, I think that as a result of the prehearing conference, Mr. Chairman, we have in fact formally gone back I think more closely to the original agenda and pushed all of the intraLATA competition, major competition issues into Phase III.

SENATOR ROSENTHAL: Into Phase III? So, it's not part of...

MR. WILK: Yeah, the only thing with it, we wanted to try to do in phase II is allow the parties, to the extent that they desired, to link filings with Phase II and Phase III into phase II filings so that we had a, had a notion as to where they were going. Some of these issues are, obviously, linked.

SENATOR ROSENTHAL: And finally, you've been quoted in the financial journals that you believe that California's telecommunications regulatory environment will begin changing rapidly. Since you are the assigned Commissioner on this investigation, I'd like to know, what problems you see with present rate of return regulation and what you personally believe is the most important change that needs to occur in a new regulatory structure?

MR. WILK: Well, I think rate of return regulation, Senator, is for the future, frankly, is archaic. I think, I agree with you that up to this point, rate of return regulation has resulted in very substantial revenue reductions in the telecommunications area. I personally have seen, and presided over, a revenue requirement reductions for Pacific Bell-- I think that their approach of about a half of billion dollars, so far, and recently \$386,000,000 for General Telephone. So from that standpoint, rate of return, traditional rate of return rate based regulation, obviously, has had some financial rewards for consumers. I'm not absolutely convinced that had we had some other type of regulation, sharing mechanisms and others that are being proposed by DRA,

PacBell, and General, that we wouldn't have received very similar benefits. My own personal opinion is, and I think if you take a look at other states, which you have asked us to do, all major states in this country, in fact, California is far behind, have concluded that the time has come to develop a system of regulation that acknowledges that we have today a blending between monopoly services--no one is arguing that we continue to have monopoly services, with increasingly competitive aspects to the delivery of telecommunications services in this State. And I think that we need this investigation's purpose is to say, what is the best way that we as regulators can oversee this process, so that we don't create a perverse incentive. And some people believe that rate of return regulation provides perverse incentives. It is a retrospective, hindsight dominated process. When, in fact, particularly in telecommunications, with technology driving costs down, and the rapid development of, of, of new products and services, that we should be having a more prospective view, and that's the reason why I believe personally that we do need to consider ways to improve the regulatory response and oversight in this industry in particular. But where that goes and what we may, or may not replace rate of return regulation with, of course, is the subject of the investigation.

SENATOR ROSENTHAL: Those that want to make the change, ought to make the case?

MR. WILK: Oh, absolutely, no question about it. The burden for change is on them. I've only indicated a willingness to entertain, if you will, and that's what that article was, a willingness to entertain and also express sympathy with the view that traditional hindsight rate of return regulation is probably on its way, on its way out. But what it's replaced with, Senator, is an open question.

SENATOR ROSENTHAL: I guess that finally then, the concept of "open process and the ability of everybody who has some input, to be involved without the concern that they might be shut off, I think is finally the... (chuckle)

MR. WILK: Senator, I know, and I, and I have had as many people knock on my door I'm sure that have knocked on your door about this and maybe even a few more.

SENATOR ROSENTHAL: (chuckle) Right.

MR. WILK: The fact is that I absolutely agree with you. And the worst thing this Commission could do is to make a silly mistake in due process for the sake of trying to move ahead on policy decisions. However, I forewarn everyone, that it is clear that we could give time ad infinitum, to this

process.

SENATOR ROSENTHAL: No, I, I...

MR. WILK: And ultimately people are not going to like decisions that are, that are, that are promulgated and, and as a result will claim that somehow they were shut out of the process. So we have to be very careful to draw a distinction between policy differences and policy fears and, in fact, legitimate due process rights.

SENATOR ROSENTHAL: O.K. Thank you very much.

MR. WILK: Thank you, Senator.

SENATOR ROSENTHAL: Now, William Thompson, the project manager of the division of Ratepayer Advocates.

MR. WILLIAM THOMPSON: Good morning, Mr. Chairman.

SENATOR ROSENTHAL: Good morning.

MR. THOMPSON: Thank you for the opportunity to be here to express our views. As you know, the division of Ratepayer Advocates's represents the interests of all utility ratepayers. And as independent advocates, the views that we express don't necessarily represent those of the Commission.

SENATOR ROSENTHAL: I understand that.

MR. THOMPSON: I have a, I have a brief five minute opening statement in which I would like to address three major areas.

SENATOR ROSENTHAL: Fine.

MR. THOMPSON: One is why we believe that the DRA proposal is a good deal for ratepayers. Secondly, we'd like to contrast our proposal to that of Pacific Bell. And we have some real serious concerns about Pacific Bell's proposal. Third, I'd like to touch upon the reasons that we believe that a change to the regulatory system is appropriate at this time.

We in DRA feel that the cost of telephone service regulatory system has served us well and that we've done a good job. For example, in 1984 Pacific Bell requested a \$1.3 billion rate increase. And since that time we have actually decreased the rates by over \$.5 billion. However, we feel that there is room for improvement. The DRA proposal will guarantee automatic annual rate decreases without regulatory lag. This will be accomplished by the replacement of the detailed rate case review mechanism with an indexing system which will impose productivity standards. Our proposal will hold utility management's feet to the fire, however, it will give them the opportunity to do well for themselves, but only if they do well for the ratepayer. In the recent past we have seen some dramatic rate decreases, and we expect this trend to con-

tinue. We project the ratepayers will be due nearly \$2 billion in rate decreases by 1993. And our proposal will capture these decreases.

SENATOR RUSSELL: Can I pursue that?

SENATOR ROSENTHAL: Yeah.

SENATOR NEWTON RUSSELL: Ah, what's the basis of that rate reduction? Is that because of technology? Or is that because we're squeezing the utilities harder? Or what?

MR. THOMPSON: These projections were, were made assuming the continuation of the current system, cost and service regulation with annual attrition reviews, rate case reviews, and the continued declining rates as based on assumptions concerning productivity and favorable economic conditions.

SENATOR RUSSELL: Is the a, is that projection, not the amount, but the direction?

MR. THOMPSON: Yes.

SENATOR RUSSELL: Is that generally agreed upon by all parties? Utilities, the Commission and the rate--and the consumers? Maybe not the magnitude or, but is everybody agreed that...

MR. WILK: Unfortunately, DRA is the only party that has filed any projections in this case.

SENATOR RUSSELL: Well, are people saying, "Boy, you're way out in left field?" or "Yeah, that looks pretty good, we agree with that". Or what kind of response, you know?

MR. WILK: (chuckle)

SENATOR RUSSELL: Never mind. Your smile answers my question, I think

MR. WILK: Those are, those are Senator Russell, those are obviously DRA's numbers...ah based upon...

SENATOR RUSSELL: Right, but what I'm trying to gather from somebody is, is there a general consensus that we are moving, or should move in that direction, or is this just their side of the picture?

MR. WILK: I think that, I think that, generally and I'll let Bill speak for himself, but I think based upon my discussions with the industry, that, that I think most people see this as a declining cost industry. But the magnitude of those costs, are very much open to questions. So these are simply one, you know one group's opinion about where they might be.

SENATOR RUSSELL: Thank you.

SENATOR ROSENTHAL: Welcome, Senator Russell.

SENATOR RUSSELL: You don't allow the audience to speak out like that.

SENATOR ROSENTHAL: No, no, we'll..the audience will have an opportunity to be on "mike" at some point...(chuckles) We'll not miss you, Mr. Vice Chairman.

MR. THOMPSON: Could I expand on that response, a little bit?

SENATOR ROSENTHAL: Yes.

MR. THOMPSON: First, I'd like to agree with Commissioner Wilk, I think it's generally acknowledged that costs are moving in a downward direction because of productivity gains and what the precise number will be for a specific company, is dependent on the analyst and what assumption he makes about future developments. As I was saying...

SENATOR ROSENTHAL: Just a follow-up on that. It is your view then that PacBell rate freeze for customers might be detrimental?

MR. THOMPSON: I was just getting to that.

SENATOR ROSENTHAL: O.K.

MR. THOMPSON: As I was saying, the, the downward trend in cost is something we expect to continue. We project rate declines in the neighborhood of \$2 billion by 1993. Our proposal will capture these rate decreases and then by way of contrast in looking at the Pacific Bell proposal, they propose to freeze residential rates until 1992 and then raise them during a period of declining costs. Then they propose to nearly double rates with the small business customer during a period of declining costs. In fact, the Pacific Bell proposal contains no mechanism to recognize rate decreases.

In summary, the Pacific Bell proposal is nothing more than a scheme to avoid regulatory intervention while costs are declining. What Pacific wants is a moratorium on any more PUC rate reductions. We estimate that adoption of the Pacific Bell plan will result in a billion dollar windfall for Pacific Bell.

The last topic I'd like to touch upon is, why change regulation at this particular time? We believe that the immediate need for some realignment to the industry relates to the emergence of new and competitive services that are provided over the phone lines. These services are commonly referred to as information aids services, or enhanced services. The current cost of service regulatory system is not well suited to handle these types of new and competitive services, because ratepayers are currently at risk for the development of these services. An example is, Pacific Bell's Project Victoria. Project Victoria costs ratepayers between \$30 and \$80,000,000. I'm sorry, I don't think I could explain the specifics of what it does, I just know of it. It was a project, it was something that was going to be marketed.

MR. WILK: I can give you a lame explanation. As I understand it, it basically expanded the capacity of the telephone lines going into the house, instead of having two pair, what is it, two doubles? You can have both voice and data at the same time, I believe, is one of the outgrowths of it. It was an expansion idea. And I believe that the reason why it didn't go through is because of the problems with the MFJ court decision.

MR. THOMPSON: That's correct. This project was...the ratepayers were at risk for the development of this project. It was developed by Pacific, even though they weren't sure they would be able to market it, the cost between \$30-80,000,000 sitting on shelf collecting dust.

MR. WILK: Producing a revenue.

MR. THOMPSON: DRA's plan would place stockholders at risk for the development of these kinds of services. We believe by placing the risk on the appropriate party will lead to the cost effective development and deployment of these new services. And that concludes my opening remarks. Thanks.

SENATOR RUSSELL: Mr. Chairman, I've got a couple observations..trying... I know that..and Mrs. Siegel has brought this to our attention, that there's some justification for the premise--is that, in developing all these sophisticated devices, and so forth, that basically serve the business community. ...if we put that on the ratepayers, the ratepayers pays for that, and the basic citizen really doesn't get much personal benefit. However, I, somehow maybe the analogy is not correct, but I remember reading in the industrial revolution when the handwork was being replaced by machines, and so forth, and the workers were throwing sand in the gear and sabotaging and everything, because they were fearful about losing their jobs. But the industrial revolution brought tremendous benefits to the small individual, as well as the industrialists and so forth and so on. So the good was spread around. Is there any kind, in your opinion, any kind of an analogy that it takes some money and support of the small ratepayer to improve the system, even though there's maybe no direct benefit, but that overall the entire system benefits the public. We have, I think, one of the finest, have had one of the finest telecommunications system in the world, and that benefits the ratepayer, the individual. If, however, there's a hindrance in allowing the telephone companies, telecommunication companies to expand and develop in ways that boggle my mind, even though it may not have an immediate direct benefit to the ratepayer, and even though they may not be able to have immediate reductions, overall it benefits everybody, it benefits the country, it benefits business,

it benefits everybody. Is there any truth to that general premise, in your opinion?

MR. THOMPSON: None, whatsoever..in this particular case.

SENATOR RUSSELL: No, in the case I'm talking about..in general terms.

MR. THOMPSON: Well, I suppose there are situations where there are societal benefits to developing something and it's in society's interest to invest in that. This isn't one of them.

SENATOR RUSSELL: O.K., you're saying then that the stockholders should bear the expense of any new expansion and they should run the risk if there's a benefit, they should reap the benefit, if there's a loss -- they suffer that? Is that what you're saying?

MR. THOMPSON: Yes, in the area of new services, that's correct.

SENATOR RUSSELL : Thank you.

SENATOR ROSENTHAL: Aside from the increasing rates, maintaining good quality of service for telephone users is my greatest concern with the probable changes that are taking place. As we move toward greater regulatory freedom, how do you perceive that we continue to oversee the quality of service?

MR. THOMPSON: The DRA proposal, we propose to continue monitoring the quality of service, quality of service would continue to be a concern. We would continue, basically continue to oversee service quality as we do today. There would be no change in that area. The changes we are proposing are to economic regulations, mechanisms.

SENATOR ROSENTHAL: Do you have any concerns about the cross subsidization in those proposals before the PUC?

MR. THOMPSON: Yes, I do.

SENATOR ROSENTHAL: Do you want to expound on them a little bit?

MR. THOMPSON: A major difference between our self and Pacific Bell's proposal is that Pacific would have all the traditional monopoly services, and new services and competitive services, all in one mix. Which would..let me think, I think that's not really responsive to your question.

SENATOR ROSENTHAL: Is there any way of separating?

MR. THOMPSON: Well, yes..yes in our proposal we would separate out the competitive services through a cost allocation means so that we could clearly identify those competitive services and place stockholders at risk for those services.

SENATOR ROSENTHAL: The PUC has continued to say that we're on the verge of change in the telecommunications arena, which we must respond to. I don't

know whether we should respond to those changes before we know what the scope of the change is, or anticipate what it might be...and that's one of my concerns. In other words... would you like to comment on...

MR WILK: Senator, we face that same dilemma in the AT&T issue. As you know that investigation was started in 1985, long before I came on board or frankly, many of my colleagues came on board to the Commission. The concern was, I mean it was related to the same issue, which is, how..are we in a position of trying to predict what the future will be like, or would we prefer alternatively to basically to make certain assumptions and make sure we have in place and we act on those assumptions, and make sure we have in place very careful monitoring and observation in place, so that, in fact, if we have criteria in place to measure the performance of the utility so that in case something happens that we don't like, we can go back and fix it. And we basically decided in the AT&T case that the latter approach was better. Which is, basically not to try to predict what the future will hold, but rather make certain assumptions about what the future will hold and then put in place frankly, a scheme of regulations and relied very heavily on observation, as Bill has suggested, for example, service quality. There will be absolutely no abdication of service quality in the State, if anything, we want to see better service quality in the State, even beyond the excellent standard of excellence we've already achieved. And incidentally service quality is one of the first things you hear about, if it drops. That, in my judgment, will be the easiest of the objectives to monitor. I'm not sure if that's responsive ...

SENATOR ROSENTHAL: Yeah, how do you monitor them after you deregulate them?

MR. WILK: Well, first of all, Senator and I need to make this very clear because in the staff document, as well, it relies heavily on the word..the notion that we're going to deregulate. We are not deregulating. We are not deregulating. Deregulation in everybody's mind is akin to unregulation. We are not unregulating anything. We're increasing flexibility, utility responsiveness to changing circumstances, we are not deregulating. We're not going to abdicate our responsibilities, have in place just and reasonable rates, that's a constitutional obligation, but we're looking for flexibility and there is this continuing preoccupation with the notion that somehow this Commission's going to deregulate--we are not going to deregulate.

SENATOR ROSENTHAL: Well, but in the process, aren't you letting go

of some of the "stick" that you have, in terms of what's happening?

MR. WILK: Well, that presumes what we may finally end up doing and again I don't want to speculate on it..on what we're going to end up doing. But I will say that we can replace the "stick". If in fact we can replace the "stick" with a carrot and get the same results, what's wrong with that? And I think, I think that some would suggest that opening up, for example, rate of return regulation and getting away from the hindsight to the perspective-- putting the company at risk, putting the compaines feet to the fire to improve its own productivity, through natural competitive means, is a far better way of doing things then having, frankly, government step in and say, "We think we're better managers of your operation." I'll admit that's a philosophical difference. But, I don't think we're giving up a "stick" I think we're replacing it with a carrot, if the carrot doesn't work the "stick" is always still there.

SENATOR ROSENTHAL: Even under the circumstance of where rates will be going up, when they ought to be going down--under their scenario?

MR. WILK: Well, it...I don't believe that again that would require me to comment on the PacBell proposal, that's up to PacBell to defend itself. I have said publicly, in fact it may have been at the very same event that you were quoting about earlier, my concern over social contract and rate freezes and whether or not we're just not locking in place rates that are higher than they should be. So, I share that concern. It's up to PacBell, frankly, to defend itself. With respect to raising other rates, frankly, I have a difference of opinion with the division of Ratepayer Advocates, at least in perception anyway. And that is that there are some services that, frankly, are below cost that shouldn't be in below cost. They should be..there ought to be some price increases. And I think you will see, and I think that you have already heard from some of the people whose economic self interest it is to keep the rates lower than, frankly, than they should be. So, I do think that there ought to be some realignment rates, Senator, in order to be able to bring, frankly, prices to cost. That's the way we ought to try to be operating in this State. Now that we're doing it in the electric industry and gas, we ought to be trying to do it in telecommunications too.

SENATOR ROSENTHAL: One final question, Mr. Thompson. You filed a petition to change the timetable for witness input on Phase II..you've heard the Commissioner indicate that may not be the problem. Want to comment?

MR. THOMPSON: Yes, I'm gratified to hear Commissioner Wilk state that

that there will be some changes. The schedule adopted by the Administrative Law judge would greatly disadvantage DRA and advantage Pacific Bell. First of all, we wouldn't be given adequate time to prepare. The hearings are beginning too soon, early November. Secondly, we see no need for a rush to judgment in this case. We believe that we should take as much time as we need to consider this very serious issue. For example, if the Commission should decide that we should continue with cost of service regulation, then we could wrap this whole thing up in fairly short order. However, if, if they decide conceptually to adopt something that's a departure from the current system, then we're going to need time to consider those implementation details. And those are our concerns.

SENATOR ROSENTHAL: Assemblywoman Moore has arrived. We've just about completed our first panel. Let me give you an opportunity, if you'd like, to raise questions of either the Commissioner or Mr. Thompson.

ASSEMBLYWOMAN GWEN MOORE: Let me apologize for being late. I was..I got delayed in another earlier..I started out at a 7:30 breakfast this morning because you know how important I think this hearing is. And I'm sorry I missed the testimony of Commissioner Wilk and certainly of William Thompson. So, my questions that I have, and I had questions, you know that I had indicated to Mitch earlier since yesterday and I'm sure he responded to them and I understand he had an announcement to make, that I probably missed, that he was going to extend the hearing--did he give us a time or did he agree with..did William Thompson and the department of Ratepayer Advocates prevail?

MR. WILK: I'm not certain that they prevailed, but to the extent that they wanted more time, we have not decided on a specific amount of time Chairwoman Moore. We have instead, I'm in the process of, in fact, finalizing exactly how much more time we need after working with the assigned ALJ and we are going to extend the hearing time, I believe at this juncture we're looking at beginning hearings instead of November 7, November 29, having the Christmas break --both of those are now associated, are identical with the DRA proposal. How much additional time we are still sorting out, looking at all the different requests for additional time just to see how much we, we need. And let me just share with you, as I shared with Chairman Rosenthal and Senator Russell earlier, it would be a silly error on our part to go through this entire process to make a mistake on due process. We have enough policy decisions that we have to reach that will be contentious enough, I'm certain that the last thing in the world any of us want to do is to make a mistake on due process.

But I will say, as I indicated earlier, that in the final analysis there will always be those who will allege due process problems and the lack of sufficient hearing time, when in fact, I would urge this Commission..this Committee to understand that a lot of those complaints are going to occur, regardless of what we do. And that as a practical matter I would urge you not to confuse policy differences of opinion versus due process issues.

ASSEMBLYWOMAN MOORE: I think we're all aware of that, but I think that the thing that I'm most concerned about, and I have to be honest with you, is that due process represents more than just a timeframe. It doesn't do any good and people don't feel that they've had due process if your mind is already made up before they go through the motions...

MR. WILK: There's absolutely nothing...

ASSEMBLYWOMAN MOORE: And there was some indication, and in some of the comments, and I have some copies of the comments that you made that gave that impression, that a decision was already imminent from some of the things that were done without hearing all the, all the sides that had to be represented. And I know that you understand how important it is that with the decision that has the kind of impact, that a decision to do regulatory reform that you're talking about, which will undo what has been done for the last fifty years. you know, necessitate an extraordinary kind of hearing so that people can be heard, and I just hope that due process means just that--that people will have due time to make their presentations and all thoughts will be considered in the final judgment.

MR. WILK: Ms. Moore, you have my assurance that..this committee also had my assurance of that a year ago when we started this process. The fact is, is that I have not made up my mind, regardless of how people may wish to cast a particular judgment. I have said that I think the time has come for change. I think we as I have communicated earlier this morning, I think we need to move away from the retrospective hindsight type of regulation. I think that anybody that is close to this industry, with very few exceptions that I know of, have already admitted that the time has come for this. In fact California is far behind many, many other states in this country and moving in this direction. But where that goes and how we get there, and how much change which will actually occur is anybody's guess. I have made it very clear, very clear to all the parties that the burden of proof as to where we go and how we get there depends on their ability to come to the table and to justify their proposals. And that's, frankly, the key and nothing I've done has certainly been intended

to short-circuit that process.

ASSEMBLYWOMAN MOORE: I guess the whole tone of the kinds of hearing that we've had is one of further liberalizing or almost dereg..I know you don't like that deregulation word. You know, that "d" word. But certainly everything that we're seeing seems to move in that direction. Whether, instead of, perhaps looking at some alternatives that would accomplish the same kinds of things without relaxing some of the controls at a time that they are probably needed. And I think that's one of the real concerns with change. Obviously New York is taking a different tone and whereas California normally is the one that sets the trends. New York is doing something that, that seems that we've kind of overlooked and that's looking at what can be done to speed up investments and other things without further liberalizing. Has the division of Ratepayer Advocates followed the New York proceedings at all?

MR THOMPSON: We did... considering our proposal we looked at proceedings in other states and other mechanisms that were adopted in other states.

MR. WILK: Ms. Moore, can I also respond too? As a practical matter, if someone has a proposal to make that, frankly, is more consistent with your view, we would certainly be willing to hear it. I mean, we have, we have, I think at least three very solidly good proposals on a lot of different respects, DRA's, PacBell's, General Telephone's. All of these have components that, frankly, based upon my initial reading of them have some components that make sense. Now, whether one ought to prevail over another or whether we ought to consider taking, taking the best of each and perhaps some more ideas. Who knows where that process...

ASSEMBLYWOMAN MOORE: Well, again I just think that, and I've got to tell you that we're going to, because of the significance of all this, and what I perceive to be a whole direction of change and little time to do it, I just think that we really need to pay closer attention to what's going on in the PUC, then perhaps we have in the past. I guess, you know, the whole way we've set up this hearing, this whole en banc and all the things that have gone on over the past year, it just seems to me that regulatory, you know this whole hearing now conflicts with the general rate cases and everything else that's going on, don't have the staff and the personnel to do all the kinds of proceedings that are occurring. And I'm just concerned that this major shift in policy in California, that will have impact for decades to come, is not going to get the close scrutiny and the staff time that's necessary because there are so many other things going on at the same time.

MR. WILK: May I just respectfully disagree Mrs. Moore?

ASSEMBLYWOMAN MOORE: O.K.

MR. WILK: I think we have ample staff to take care of this. We are... this investigation has not conflicted with our carrying out the existing rules. The rules, after all, stay the same until they're changed. And we have been vigorous in our enforcement in the past year and a half I've been on the Commission. I have personally approved rate decreases for Pacific Bell in excess of a half billion dollars for General Telephone and close to \$400,000,000. I think the process...

ASSEMBLYWOMAN MOORE: Well, I know you don't want me to go into all those things... .

MR. WILK: I know, but all I'm saying is, is that I'm using those as an example of the fact, that this investigation is not inhibiting our ability as you... .

ASSEMBLYWOMAN MOORE: Well, let me put it like this. Let me ask the DRA people, how many staff people do you have assigned to your division?

MR. THOMPSON: I currently have three people working for me on this project. So that's on a full time basis. That's four people including myself.

ASSEMBLYWOMAN MOORE: How many are in DRA, in the DRA, how many then are assigned to the rate case?

MR. THOMPSON: Division of Ratepayers?

ASSEMBLYWOMAN MOORE: The telephone aspect of DRA? I guess some of you are doing work in other areas?

MR. THOMPSON: Yes, there's approximately 50 people in DRA working in telecommunications cases.

ASSEMBLYWOMAN MOORE: O.K. How many professional staff? Fifty?

MR. THOMPSON: Fifty, yes.

ASSEMBLYWOMAN MOORE: O.K. How many are assigned to the regulatory reform proceedings? Is that how you do it? Tell me how you assign.

MR. THOMPSON: As project manager of this particular case, my total focus is this case coming up with doing the technical analysis, coming up with the proposals, and so I'm not...it's difficult for me to respond because I don't know what the staffing is in other areas. I can specifically...

MR. WILK: Mrs. Moore I have never received, nor have any to my knowledge any of the Commissioners received any complaints from DRA that they're understaffed, that they can't do the job; in fact, I think their proposal speaks

for itself. The fact that they...

ASSEMBLYWOMAN MOORE: Well, I think that one of the things that they did mention at the OII was that they were going to be pretty stretched doing all the proceedings that...

MR. WILK: Well, I haven't seen, I haven't seen evidence of it yet.

ASSEMBLYWOMAN MOORE: ...were going to go on.

MR. WILK: I think that they're doing an outstanding job here.

ASSEMBLYWOMAN MOORE: Well, I mean, I guess what I'm really trying to understand is, either you're going to be stretched or you're not. If you've got a small staff and you're doing two or three major hearings, you know, I'm the one year rate case person and was told that we didn't have the staff and the stuff to do it. And now you've got three proceedings in one, all going on at the same time, and I just wonder what kind of...

MR. WILK: All I can say Mrs. Moore is that I believe, I am convinced, that we have adequate staff to do the job we need to do and I would say, judge us on our results.

ASSEMBLYWOMAN MOORE: I'm not going to prolong this. Can I just..like to see the staffing pattern that's going on and that will be used in each of those proceedings, and how the staff is deployed, and what's going on at that time, because I want to insure that people who feel some competence in the Department, Division of Ratepayer Advocates, that they're being represented, and that their concerns are being represented, that it is truly doing so. And so I'd like to see that. I'm just sorry that I missed the rest of your testimony.

MR. WILK: As I say, judge for yourself. I think they've come out with an outstanding report. I have some problems with it, in some respects, but I've always been one that viewed the results as being more important in many cases, and I think that if they had staff problems, I don't think they would have been able to come out with some of the work that they have.

Mr. Chairman, thank you very much. I do have...

ASSEMBLYWOMAN MOORE: Oh, can I ask one last question, I'm sorry, I won't do it again. Tell me, what was the thought behind putting over the competitive issues to Phase III of this, isn't that kind of like putting the cart before the horse?

MR. WILK: Well, frankly, it was to try to use the time efficiently. That we're going, in essence we're going back to the original schedule Mrs. Moore. It's nothing new. We're just basically going back to the original schedule

where Phase III was going to take care of intraLATA competition issues.

ASSEMBLYWOMAN MOORE: But wasn't the idea behind the competition was to give the utilities the flexibility in Phase II...

MR. WILK: IntraLATA competition...

ASSEMBLYWOMAN MOORE: ...to be able to be competitive. I mean, so how do you divorce the two?

MR. WILK: Well, we have and we have as far as I know based upon the consensus we heard at the prehearing conference was to defer a lot of those issues to Phase III like it was originally contemplated.

ASSEMBLYWOMAN MOORE: Oh, consensus between whom?

MR. WILK: Of the parties. Mrs. Moore if I don't get out of here, I'm going to miss my plane. I've got to the Diablo...

ASSEMBLYWOMAN MOORE: Oh, I bet you will. I'm just sorry that I wasn't here. O.K.

MR. WILK: That's ok. I've got a Diablo Canyon hearing this afternoon which is also rather a small issue...

ASSEMBLYWOMAN MOORE: Well, next, when I hold my hearing maybe we can get a little better cooperation, a little longer attendance. I'm just sorry I had to be a little late.

MR. WILK: I don't think there's a problem with cooperation on behalf of PUC, Mrs. Moore.

ASSEMBLYWOMAN MOORE: Well, fine.

SENATOR ROSENTHAL: Thank you, Commissioner. O.K. We'll, I guess..any other questions for the DRA? All right we'll move to the next panel. Local utility..California utilities. Bruce Jamieson, Timothy McCallion and Barry Ross.

MRS. SYLVIA SIEGEL: I'm sorry to have to go out of order. My statement will be extemporaneous as it usually is. I'm one of the parties in the Diablo case too and the hearings there will start at two o'clock.

While it's true that technical innovations are forcing a new look at regulation in the telecommunication industry, I think we have to proceed cautiously. What is happening now at the Commission, I'm sure you're all aware, is not only a review of a general rate case that has been going on for several years, not because of anyone's intention to extend it except the company itself. In other words, every time a witness comes in to dispute PacBell's testimony, PacBell in return puts on three witnesses. That fact alone has extended the general rate case way beyond its normal time. We would

have been happy to have seen that resolved a long time ago and it should have been. Before you approach anything in the way of regulatory disintegration, I think it's important to look at what you have now. And we do not have a proper look at what exists now. Before we take anything apart, before you attempt to invoke flexibility, before you allow unfettered new services paid for in part by the ratepayers, I think it's important to do a stand alone cost study of the local telephone system, so we know precisely what it costs to serve local customers. We then know what any incremental costs are for enhanced services and for other services that depend on the basic infrastructure. Until we get that kind of study, you are invoking new programs, new changes, forcing the ratepayers to become the capitalist investors, and that's not the role of the ratepayers, and I think even Senator Russell would agree with me on that. But I think it's important to proceed cautiously, to thoroughly explore everything that's involved in this case and other related cases. And there are a number of related cases. Not only do we have this investigation going on, but the advice letters are coming in so thick and fast, I can't even keep up with them. I understand one came on the eighteenth that conflicts with some of the things that have been affected, like the so-called settlement on rate of return. I haven't even had time to dig that one out and look at it. We have to be very cautious. I don't trust PacBell as far as you can throw a digital switch. And I, I think what you have to do is examine each piece of it very closely and examine how the pieces fit together. I respectfully submit that our witness Dr. Walter Boulder, who is one of the prominent telecommunication economists in the country, is preparing his testimony now, as are experts from all of the other intervenors. Those testimonies are not in today, and I expect that's why Bill Thompson maybe couldn't answer some of your questions. We have to wait until that testimony comes in, until everyone has an opportunity to review it, 'til it's tested by the process of cross examination to determine if there are any flaws, or if there are any addenda that need to be made, and to put that into the pipe and have the smokers at least take a look at it. And I'm not convinced that this assistant Commissioner, or his boss, are really looking at any of these things in detail and giving it the thought that's required. Ms. Moore, at the current time we do have enough staff. If any of this proposal goes through then I'm going to be the first one up here recommending a substantial staff cut. We don't need 300 people to watch them monitor a disintegration of a telecommunication system. We have tried, the Commission has now tried, and you're all aware of this, restructuring the natural gas

industry. I have to tell you it's the biggest mess you ever saw. And you ask the utilities, all the parties agree, it's chaotic. That's why, that's why ladies and gentlemen I think it's urgent to proceed cautiously to give everybody enough time to go into the nitty gritty, this is the only time we're going to have to go into the nitty gritty. First, and foremost, we want our money back now. We still have hundreds of millions of dollars that are due to be refunded. I don't want this melted into some hocus pocus scheme and they're going to throw us a bone, that really isn't even a bone. It doesn't cost anything to knock off the touch-tone service. Touch-tone will save Pac-Bell a huge amount of money, because it involves less holding time on the line if you have a touch-tone phone. So they're going to save money if they get rid of those charges and implement it universally. The 'zum' charges are a fraud and have been from the beginning. We live in metropolitan areas, we need to have forty mile calling areas. What's good enough for Atlanta, Georgia, is good enough for this civilized community of Los Angeles and the other metropolitan areas in California. That can be done, sir. And that will enhance the growth of the telecommunication industry, if you have everybody have available calling within their community of interest, that's forty miles. It's forty miles here in Los Angeles, it's forty miles in San Diego, its forty miles in Orange County, it's forty miles in Sacramento, San Francisco and Fresno, and would become so in the new growing north San Joaquin valley area.

SENATOR RUSSELL: For the same price?

MRS. SIEGEL: You bet for the same price. Because prices are going down Senator. They're not going down fast enough. We have something like \$700,000,000 on the table now that's due to refund. They're going to mess around with it and they're going to play a shell game, offsetting one thing against another for four months mabybe, it's not clear, not on an annual basis. It's not clear and I have to analyze that advice letter. They're going to play around with all of these games, they're very slick. And if you follow the history, as I know you do Senator Russell, you know that every 6 months they have a little change to their master plan. They did in the submission now under George Smith's testimony, they've added a couple of other components. I urge you, you are the only thing we have to rely on. We have twenty-what?-seven million people in this State. It's not necessary that every house in California have voice and data transmission capability. We have it now. If I had a computer in my house, and I may get one, I can work it very well with the quality of transmission and switches we have now on Pac-Bell. So can

everyone else. No household is going to put in extensive banks of computers, and this kind of enhancement of the infrastructure is strictly for the benefit of PacBell and ought to be phased in at investor expense.

SENATOR RUSSELL: A question on that...

MRS. SIEGEL: Go ahead.

SENATOR RUSSELL: On that point, when we were in France we saw the monitors, T.V. type monitors, where you have all kinds of services, and those were provided to businesses as well as homes. Now, that kind of equipment, can that function as well, in your opinion, on the existing system?

MRS. SIEGEL: Yes. Yes.

SENATOR RUSSELL: Or does there need to be, you see, what--I hear what you're saying and there is a lot of truth in it, but what concerns me is that there is an overall growth in improvement of all kinds of goods and services in this country as scientific advances progress. And if we say, well, this is good enough for everybody here then it seems to me somewhere in the mix of things that then slows down the overall growth so that in twenty or thirty years, instead of being up here in competitive status with everybody else maybe we're down here. Do you understand what I'm trying to say?

MRS. SIEGEL: Senator, as you know, my two children are electrical engineers in the computer field and believe me they would push me from their end into accepting modernization--which I do, up to a point. But, why should ratepayers who are buying a basic necessity pay to modernize, and pay to enhance an industry? This is not their responsibility.

SENATOR RUSSELL: And I, I don't think they should. But, by the same token, there is a modernization that goes on at all levels for everybody.

MRS. SIEGEL: Right.

SENATOR RUSSELL: In ten, fifteen, twenty years it, what we do today will determine where we are then.

MRS. SIEGEL: Senator, several months ago I was at a conference where there were a lot of independent telecommunications purveyors. They were outside businessmen. They were regulators and the regulated companies there as well. The outside businessmen said they're perfectly capable of providing enhanced services. They are not only willing, but they're doing it. So, I think they ought to be encouraged. As you know, the computer development was by private industry. Not by a regulated industry. The new fax machine is being developed as a, at a rapid pace, not by regulated companies but by private industry. And the saturation level there, in the small time-frame where it has grown so rapidly, is an amazing thing. And it's all being done under

the guise of private industry. I'm all for free enterprise and I know you are too. I'm not for pushing from the top down the growth of an industry where the impacts are hideous on the middle class and the low income people. This doesn't mean that I'm a wart on the wheel of progress either. I want to see progress. But, for example, not everybody in the world is using ATM machines. Not everybody in the world is using the credit cards that go into telephone machines. I sure as hell don't..excuse me..I sure don't use them. I don't trust a lot of these new gadgets. And once you make a mistake, it takes six months to unravel it. We have enough trouble now helping people unravel their complaints on the existing telephone system. Nonetheless progress has to be made. I think, Senator, if you will look, and I'll be happy to send you a copy of our testimony and I'm sure the other parties will too, I want you to know what all is involved. I don't think anything ought to proceed until we have: 1. we get refunds now with the money that's due back to us, I don't want to see them playing games with them; 2. we have a stand alone cost study; 3. then let's sit down and talk turkey.

SENATOR ROSENTHAL: You heard the Commissioner indicate that there would be more time for interested parties.

MRS. SIEGEL: Two weeks isn't much time.

SENATOR ROSENTHAL: OK.

MRS. SIEGEL: If that's what he said. I missed what he said. I thought the schedule was going to go from November 7th to November 29th. Beyond that, I don't know.

SENATOR ROSENTHAL: OK. Do you have any..Can you give us a brief comment on this? On this report? Is it good?

MRS. SIEGEL: Little pieces..little pieces of it are fine. I'll give you a full comment on it and present you with our written comments on it.

SENATOR ROSENTHAL: Fine.

MRS. SIEGEL: I think they're trying to out maneuver Commissioner Wilk and think..and try to guess what he's going to accept.

SENATOR ROSENTHAL: OK. Any further questions?

MRS. SIEGEL: The DRA can be political too. The only one who isn't political, is you know who.

ASSEMBLYWOMAN MOORE: Let me ask..if I can, I'd like to ask..Mrs. Siegel..

MRS. SIEGEL: I got up early this morning.

ASSEMBLYWOMAN MOORE: How many..how many proceedings can you handle at a time?

MRS. SIEGEL: We're in from seventeen to twenty proceedings a year.

ASSEMBLYWOMAN MOORE: I said...

MRS. SIEGEL: Handle them with varying degrees.

ASSEMBLYWOMAN MOORE: When you got, when you have four or five important issues, how much intervening can you do? I know about your staffing pattern.

MRS. SIEGEL: Well, we try to stretch, Ms. Moore, it's extremely difficult for one party to get involved in all of the major proceedings at the Commission. They're all equally important, if they're major ones. I don't expect the Commission to change its schedule because of the intervenors, but I do expect the Commission to give all intervenors a proper amount of time in good faith, to pursue their individual interests. And even though we may engage outside consultants, our consultants have tight schedules as well, and they need time to make their studies, and investigation and recommendations. It all takes time. You can't do it in two minutes. And I'm not going to be rushed and I'm not going to stand by and let them push us around and let them rush us into a proceeding without the full facts on the table. You're not going to short-cut the process. I've spent twenty years in this business. And I'm representing a large constituency and their..they have a right to proper representation and to proper regulation, and we're not going to be squeezed out of it.

ASSEMBLYWOMAN MOORE: What about this new process, by invitation only, have you been getting invitation to participate?

MRS. SIEGEL: I don't get invitations.

ASSEMBLYWOMAN MOORE: But you're the intervenor.

MRS. SIEGEL: Well, that may be. I haven't seen any invitations. You mean to settle?

ASSEMBLYWOMAN MOORE: Yeah, don't you get invited to participate to represent the people that you normally would be on?

MRS. SIEGEL: Well, I think they know my attitude on settlements. I think, generally, they're raunchy. Settlements..sometimes settlements on some specific narrow issue that can save time and the hearing process may be indicated. But when you're rolling the dice, for example, on six billion dollars on the Diablo case which is built on a stack of cards, that settlement agreement is, you can blow it apart in two seconds. I think it's outrageous. I think it's sinful. I think we're going to pay for it through the nose for years to come and we won't be able to enter metal in that. This is a thirty year agreement and we're going to be stuck with it because the DRA and their great wisdom, and PG&E through intervention of Warren Christopher of O'Malveny, and the great politician John Van de Kamp decided in their respective visit..wisdom

it was good to settle that case. It's a horror story. The same is true...

ASSEMBLYWOMAN MOORE: Of course there were a lot of reasons for doing that, including the rate of the money that was being accumulated in the fund. I mean, there are a lot of reasons, and not necessary...

MRS. SIEGEL: There may have been some other reasons.

ASSEMBLYWOMAN MOORE:...that it's good. But I guess the thing that I'm saying is that, on the big ones you're saying that stipulated agreements are inappropriate because they don't stand the test of scrutiny of all the parties that would normally intervene.

MRS. SIEGEL: That's exactly right. There is just too much at stake. You know, if you go into this flexibility scheme we will never know what it costs to provide these services. We will never be able to follow any cross subsidy. And there will be cross subsidy.

ASSEMBLYWOMAN MOORE: Pacific tells me that they have study after study, all kinds of cost studies that demonstrate...

MRS. SIEGEL: Who tells you that?

ASSEMBLYWOMAN MOORE: Sure, they've said it all along they have. But I bet you Bruce Jamieson is going to tell us that.

MRS. SIEGEL: The cost studies are flawed. We haven't seen one that was really a good cost study and we've been after this, as you know, we've testified before these committees before. We've been after this for at least several years. They..PacBell's cost study improved a bit, but it still is not a good cost study. What you need, basically, is a stand-alone cost study for local telephone service. Then, we really have the....

ASSEMBLYWOMAN MOORE: They say they've got it. What is it, twenty-nine something dollars a month?

MRS. SIEGEL: Well, that's what they say, I don't think it's true.

ASSEMBLYWOMAN MOORE: They say they've got the facts.

MRS. SIEGEL: Well, that's their facts, according to them. The facts according to them and the proposal according to PacBell and General Tel-- I don't want to leave you out...

ASSEMBLYWOMAN MOORE: I haven't seen General Tel's study, that's why I just keep picking on PacBell.

MRS. SIEGEL:...Are a lot different than the facts according to an objective outside investigator.

ASSEMBLYWOMAN MOORE: All right, so what you're saying is that the Public Utilities Commission on its own should commission...

MRS. SIEGEL: It's insufficient.

ASSEMBLYWOMAN MOORE: Who should do the study?

MRS. SIEGEL: Well, I think they should do it.

ASSEMBLYWOMAN MOORE: They, who?

MRS. SIEGEL: But they haven't done it.

ASSEMBLYWOMAN MOORE: Who?

MRS. SIEGEL: The PUC should do a stand-alone cost study.

ASSEMBLYWOMAN MOORE: That's what I'm saying. But you're saying that the Commission should do..challenge...

MRS. SIEGEL: Right, a stand-alone cost study. I wouldn't rely on Pac-Bel to do it.

ASSEMBLYWOMAN MOORE: But...

MRS. SIEGEL: Not without a lot of input...

ASSEMBLYWOMAN MOORE: But what I'm hearing from the Commission, they can't..whatever they do would be totally dependent on what information they got from the telephone company. So how do you get an objective study when the object of who you're trying to be objective to, is the total source of information?

MRS. SIEGEL: Except that that's true, Ms. Moore. I recall four or five years ago when Dick Gable for us, was doing a study and he couldn't get the information out of staff, and he couldn't get the information out of the sources that were assigned from PacBell. He went to the engineer, the operating engineer of PacBell, he asked them a series of questions that answered what he would--he had to have. And he got the information, so you have to know how to get it, out of which people--and go to the right people to get it. The Commission staff has a statutory duty and obligation to get the information. They're the only ones that can go directly to the source. We can do it too. It just takes us longer to dig it out because they'll put more roadblocks in the way. But we can get it. It costs a lot of money, but you can't proceed in any kind of restructuring until you have that kind of study.

ASSEMBLYWOMAN MOORE: I guess, finally, my last question to you is centered around this whole notion of modernization and who pays for it and who shouldn't and obviously you think that basic service does not include modernization kinds of services. If everybody benefits, in the sense that everybody has access to the same kind of services, then do you think that everybody should pay?

MRS. SIEGEL: Well, we do have a policy, public policy in this state

of universal service and we do have a..but that goes hand in hand with a lot of other things, if we're not going to have..if they're going to D average, then we have to look very closely at how, who pays for the modernization. So, you can't pick one cherry off of the tree and consider it separately. There're other pieces that fit into that puzzle and that consideration.

SENATOR ROSENTHAL: We're going to have to move on.

MRS. SIEGEL: Alright. Thank you...

SENATOR ROSENTHAL: Thank you very much, Sylvia. Go catch your plane.

MRS. SIEGEL:..very much.

SENATOR ROSENTNAL: Ground rules. You've all indicated, it's been indicated to each one of you that you have about ten minutes to make your presentation, so that we can then spend the time asking questions and I'm going to hold each one of you to that so if you'll just..this ten pages for example will have to be synthesized and tell us just briefly what it says. And we're going to go right to left. Mr. Jamieson, Executive Director, Regulatory, Pacific Bell.

MR. BRUCE F. JAMISON: Good morning, Mr. Chairman, Assemblywoman Moore and Senator Russell. I'm Bruce Jamieson, Executive Director, State Regulatory for Pacific Bell. I'm the project manager for responding to the Commission's OII investigating change regulatory structures. I've prepared remarks; I have copies of them here. I would like to highlight a few points in those remarks and talk about some of the items raised in the Committee's staff report, which we received last week.

First, just briefly on Phase I. Phase I settlement came about through a series of negotiations which were sponsored by the Division of Ratepayer Advocates. They held negotiations that resulted in a settlement that was filed with the Commission in April, the first of April, a final decision on that was not received until sometime in September. Of the forty-two parties that were represented in that negotiation process, about two-thirds agreed to the settlement. The important thing about that was, that indeed, it worked. There was compromise. For example, Pacific Bell went into Phase I saying that all intraLATA consideration ought to be moved to Phase III. We were told to discuss intraLATA private line competition in Phase I. As a result of the settlement we agreed to extend already existing competition to voice grade high capacity private lines. As to competition itself, what we have proposed in the area of changing regulatory structures is really independent of intra-LATA competition. Our proposal is based on what we originally discussed in

1986, with some improvements. Our proposal merely recognizes the existence of the competitive situation, it does not initiate that situation. Some people have raised an issue about interLATA competition. Our record on that is clear. We think the ban on interLATA competition ought to fall as well, but we have never said that we are interested in getting into facilities based competition at this time. We have said we might want to have the ability to be a reseller in interLATA services. That issue is not an issue this Commission can address, that's an issue for the federal government.

SENATOR RUSSELL: Question on that point. Does..was your original position that there should be competition soon after the breakup of AT&T?

MR. JAMIESON: No. InterLATA?

SENATOR RUSSELL: Yeah.

MR. JAMIESON: I can't recall the initial responses, but the first triennial review of the MFJ, modified judgment, we said that the ban ought to be lifted. That was 1987 and undoubtedly before that, but I don't have the specific site.

SENATOR RUSSELL: So, you are from the beginning wanting competition? IntraLATA.

MR. JAMIESON: We have said that the ban is inappropriate. We have not said that we were raring to get into that business.

ASSEMBLYWOMAN MOORE: Excuse me, did you say that Pacific asked the judge to remove the ban on intraLATA competition?

MR. JAMIESON: In the mod..in the triennial review we have said that the ban is an inappropriate today and ought to be removed. But we have also said..

ASSEMBLYWOMAN MOORE: I'm sorry you lost me. What did you say?

MR. JAMIESON: We said the ban ought to be removed on interLATA competition at the triennial review that Judge Green required three years after the original settlement.

ASSEMBLYWOMAN MOORE: How come you didn't go the other way?

MR. JAMIESON: I don't understand your question.

ASSEMBLYWOMAN MOORE: Never mind.

SENATOR RUSSELL: That's the long distance competition, right?

MR. JAMIESON: Yes, sir.

SENATOR RUSSELL: And you don't want competition with intraLATA within the State?

MR. JAMIESON: Well..

SENATOR RUSSELL: Within the State. Is that right?

MR. JAMIESON: We have, yes, part of our proposal in Phase II we said you need to think about where competition is going inside the LATA as well. And we believe that you can't hold back competition. It's coming, there already is competition. So we have also said our proposal for Phase II, while it doesn't address the details of what intraLATA competition--terms of conditions ought to be, we need to recognize that intraLATA competition is likely to come. There have been several decisions which have allowed for some form of intraLATA competition already.

SENATOR ROSENTHAL: Well, I'm really confused here. I don't recall when you thought that there ought to be competition intraLATA.

MR. JAMIESON: That is..Senator, that is correct. We've for a long time said that there should continue to be a ban on intraLATA competition. That's based in part on the fact.. was based in part on the fact that there is a ban on us participating in interLATA competition. The fact is, that as time has passed, intraLATA competition has been developing and there have been decisions which have allowed intraLATA competition to develop. Our proposal now saying that we have considered changes in regulatory structures within a context of having intraLATA competition, in no way says that we were out supporting that. It says we're reacting and responding to a changing environment.

SENATOR ROSENTHAL: Was it your intention in announcing your desire for intraLATA competition, to take away the opportunity for the PUC to determine if Phase III, if intraLATA competition was a good idea? And therefore expedite the investigation even faster?

MR. JAMIESON: Not at all. We felt that we needed to, because the question of intraLATA competition is so important and because we had been a very strong opponent of intraLATA competition. We felt, given that the environment was changing in Phase I, the settlement in Phase I included intraLATA competition for high capacity private line services. We believe, looking at all of the changes that were coming, that intraLATA competition needed to be addressed. And so what we said in our--when we released our filing was in effect you have to consider changed regulatory processes within a framework that there is likely intraLATA competition. But clearly the terms and conditions and how that competition is expanded and evolve are very complex subjects and necessarily have to be addressed in Phase III.

SENATOR ROSENTHAL: Well, while it appears to be generous on your part, isn't this really a safe offer-- due to your secure captive customer base?

Supposing somebody said that information that you now have in order to make that an even playing field has to be made available to some competitors in other areas other than voice. Do you have any problem with that?

MR. JAMIESON: I think today many of the proceedings that deal with those kinds of things are heading to that kind of a conclusion. There are complex issues there; I'm not thoroughly schooled in all of them myself.

SENATOR ROSENTHAL: OK.

MR. JAMIESON: The Division of Ratepayer Advocates, ^{representative} Mr. Thompson, described their proposal and then described some of the items in our proposal. I would suggest that some of that was mischaracterized and needs to be corrected. We have proposed in Phase II revenue reductions that between now and 1993, that will come to over a billion dollars a year. He's talking about saying there is 2 billion; we proposed already that there is over a billion dollars of reductions that we are ready to come forward with. That includes touch tone for resident services and the expansion of the local calling area. Another key area that Pacific has addressed is the infrastructure. Quite frankly, Pacific's critical of those who, in effect, would draw a circle around the network as it exists today, for whatever reasons. Some say, for example, that service is adequate today and that the infrastructure somehow should take account only of those services that are being offered. Some others would draw this circle around the infrastructure saying that providing those new services, which can be provided in the network as well as other places, ought only be provided by them, not provided at all by Pacific Bell. I would submit that had we had such an argument in 1934 when the Federal Communications Act was passed and drawn such a circle around the network, we might very well today be living with a network that consists of a great deal of manual service at a great--higher price to customers. It is the kind of investment that has got on in the network that has allowed that service to evolve. In our proposal in Phase II the risk reward mechanisms that we have proposed will encourage proper research, proper development of the network, so that that network can evolve over time. The commitment to the improving network really is important for the assurance of a strong telecommunications infrastructure. Pacific's committed to that concept, particularly at the time when the information age is emerging in California and access to that needs to be made available to all Californians and not just those who can pay for it through private networks. And it's also important, considering the emerging important position of California, for the United States and the Pacific Rim. Thank you.

SENATOR ROSENTHAL: Since the PUC seems to be moving in a more flexible manner, flexible direction to accommodate requests, do you hurt your own cause by pushing for an expedited process?

MR. JAMIESON: I'm not certain I follow your questions.

SENATOR ROSENTHAL: You're the only one asking for an expedited process it appears.

MR. JAMIESON: I don't think we were asking for an expedited process, we were suggesting that we could meet the schedule that was proposed, we think there has been a long lead into this. The Commission has been issuing statements making announcements calling for OII having en banc hearings leading to consideration of change, frameworks. As Commissioner Wilk pointed out, once you set a schedule it's a great encouragement to try to start it and we're ready to start.

SENATOR ROSENTHAL: The Commission set a schedule for one year for all three of them, which we said was too fast and I'm still convinced that even the schedule which has now been suggested is too fast. We're going to make a change in a system which has been in existence for fifty years. What's wrong with taking another six months?

MR. JAMIESON: Well, the fact that the Commission is now only starting Phase II indicates to me that, as adjustments needed to be made the schedule has been adjusted and I'm sure they will continue to do that should it be required.

SENATOR ROSENTHAL: I guess one of the things that becomes a concern is, whether or not the quality of service the customers need under this rate flexibility plan will be guaranteed, if we rush to make the changes without looking at all of the ramifications. I just have a concern that you would like to see changes made faster than I would.

MR. JAMIESON: Well, as to service, Pacific has never, ever suggested that it should step away from the high quality service standards that it is required to maintain today. In fact, part of our proposal clearly addresses the issue of service and the continued commitment to those high service standards. We can't afford to do that. It'd be bad business..we've got to have good service.

SENATOR ROSENTHAL: No, I'm not suggesting that you'd want that to happen. I'm just concerned that this rush to change could affect quality of service.

MR. JAMIESON: Well, I would..I'm not certain..I guess I don't believe it's necessarily a rush to change. I believe that the proposal that Pacific

has made is, in fact, a fine tuning of the system. It is not requesting deregulation. It is not stepping away from rate of return regulation. It is a modest step recognizing the changing environment and in fact, sets up a situation where whatever changes are needed down the road, can be accommodated. It clearly is not a call for deregulation.

SENATOR ROSENTHAL: You mean you can put the toothpaste back in the tube?

MR. JAMIESON: I think our proposal is one that does not allow very much toothpaste out of the tube at this time, Senator.

SENATOR ROSENTHAL: Well, that's really the debate. That's really what this is all about. That's why everybody is opposed to what you're suggesting. All of the other forces out there appear to be in opposition. What do you say to those competitors of yours who say that the recent PUC penalty for over-capitalization shows that your utility is willing to use ratepayer investments to unfairly compete?

MR. JAMIESON: First of all, we don't use ratepayers money to invest. That's the investor's money. The ratepayers--customers pay for service to the extent that they want to buy those services, they buy them. We're not using ratepayer's money to advantage ourselves to unfairly compete.

SENATOR ROSENTHAL: But if you provide a service that people..if you provide a system, which provides a service for everybody whether they want to use it or not, and then charge the rate base..and then they have to pay for it, there's something wrong with that concept it seems to me. That's the problem.

MR. JAMIESON: Well, there's a dilemma, and the dilemma is...

SENATOR ROSENTHAL: I understand.

MR. JAMIESON:...that network based services, Pacific has always believed that network based services should be part of the regulated business. To the degree that you try to separate those and put them below..put them outside the regulated business and Pacific has said if that ultimately is the stand of the Commission, so be it. But to the degree that you do that, I think we run a very serious risk over time of emaciating the telecommunication infrastructure in California, at the very time it needs to continue to be enhanced.

SENATOR ROSENTHAL: Then why did DRA ask for penalties on this point?

MR. JAMIESON: I think you're probably talking about the modern...

SENATOR ROSENTHAL: We're talking about over-capitalization.

MR. JAMIESON: I believe you're talking about their allegations on modernization. They are poking around at decisions that were made four

and five years ago. That review has been going on for some very long time and we believe when that finally goes to litigation that the reasonableness of Pacific's investment will ultimately be shown.

SENATOR ROSENTHAL: Any further questions? Thank you very much. Mr. Callion..Director of...

ASSEMBLYWOMAN MOORE: Can I..I'd like to ask just a couple of questions. One on the expedited hearing process. PacBell, of course, is as Senator Rosenthal pointed out, is one and probably General Telephone, the telephone companies appear to be the only one's that seem to think that the expedited proceedings are appropriate. You pointed out in your comments to Senator Rosenthal that everybody had plenty of lead time because they were notified, you know, at least a year, you know in the proceedings. I guess going all the way back to the en banc hearings that began in August of '87. The notice ..I guess the first notice came out en banc it was actually in October, I guess. Is that what you meant when you were saying that everybody had adequate time to know that all this was going on?

MR. JAMIESON: Well, the Commission did have the en banc. Then in November of last year, the Commission issued the order instituting the formal investigation and laid out a tentative schedule, as Senator Rosenthal said, called for it to be completed over a year's time. There have been modifications to that schedule by various rulings throughout the year. But the intent to investigate the telecommunications regulatory structure has continued to be there and these modifications have shifted the process slightly.

ASSEMBLYWOMAN MOORE: I guess that the point that I want to make is that we're just finishing Phase I, one year later. And yet we think we can get through Phase II which has many rep...in fact, we're not even finished with phase I because the implementation of Phase I has not occurred because there's some discussion or division over how that ought to be done and some opposition to your proposal, as to how it ought to be done. And yet you feel that...you know and we just heard about how you bring in three to one, in terms with all the resources you have, that you could, that a three month schedule is adequate opportunity...you know, to be completed by the first quarter, I guess is what the initial suggestion was. And it just seems to me a bit unfair to others who don't have the resources that the utilities have available to them then some of those people we depend on to, at least, intervene and have an opportunity to scrutinize and see if we can't get the best. And I just think that everybody ought to have, you know, some adequate time. Everybody doesn't

have three to one odds. Or three to one folks that they can bring in. And I just think that it's a bit unfair to do it in the manner that you're talking about. And again you go to the high quality of service, I guess I'm making a statement, it wasn't a question, unless you want to tell me that it is fair?

MR. JAMIESON: Well, the only comment I would make is that we released our proposal for phase II before the filing was required, so people could get a early look at it. We, in the setting of the hearings start, we said we could start when they originally said they would start. The original order said it would start...

ASSEMBLYWOMAN MOORE: I guess you can. I guess the point...that's not the point, I'm sure you could, given the resources and the things available to you. You can have people work around the clock. Other people don't have that opportunity. And if you had to expedite or you had to do extra things that normally you would not have had to do, then you can understand the burden that this places on others who have...just don't have the resources. And I guess that's the point that I was trying to make and I'm not going to belabor the question. I want to go to your high quality of service that is not impacted by any regulatory flexibility or the other kinds of things. There has already been some question about the quality. Things have changed. The emphasis now is on profit, not service. And the question, in terms of what's happening to...I guess if I wanted to talk about polls, I guess polls are one of the most important things. I bet if I run a poll now, and I've seen a number of studies that have already been done, where people don't think your quality of service is the same. Are they wrong?

MR. JAMIESON: I don't know specifics about that. But I can assure you that, to the extent that those kinds of things become known either through our, our own polls which go on, and/or through service monitoring which goes on, and that we're required to do and submit to the Public Utilities Commission or through normal complaints, should those kinds of things come to light they need to be addressed very quickly and they are and need to be...

ASSEMBLYWOMAN MOORE: There are some things a formalized complaint system does not lend itself to. People don't understand how to go about complaining about...but we get letters. Whether it relates to the information service, where people haven't got a yellow pages or a phone book, and they have to call and then find out suddenly that they owe a quarter for talking to a recording that gives them the number that they may have missed and then they have to call right back and do it again, which costs them another quarter,

and all those other kinds of things. And, you know, everything from some things that are beyond your control, obviously, and I'm not arguing those. Last question, that I really have, and this is a question, it relates to how you plan to recoup the money for the touch-tone in your Phase II? Could you refresh me, real quickly, on what your proposal was on that?

MR. JAMIESON: We have proposed in Phase II that touch-tone be included in the price for basic service and that the local calling area be expanded. That, indeed, is in effect a rate reduction. We have said that ought to be a replacement for attrition for 1989 and that's a good step-off point to move to a system which establishes a benchmark rate of return. And if we...

ASSEMBLYWOMAN MOORE: Alright, now...

MR. JAMIESON: ...and if we do better...

ASSEMBLYWOMAN MOORE: O.K. Let me ask this. Then how do you reconcile that, with the information that the cost of providing touch-tone is no more than rotary, with the kinds of switching systems that the company now has?

MR. JAMIESON: We need to separate whether we're talking of costs or revenues. Pacific receives about \$100,000,000 roughly in touch-tone revenues from resident customers today. What we are proposing, is to no longer collect that revenue...

ASSEMBLYWOMAN MOORE: But, if we're moving towards cost based pricing, how do you separate the two?

MR. JAMIESON: Well, the costs will still be there. We're saying that today basic service doesn't cover its costs and will continue not to...

ASSEMBLYWOMAN MOORE: Well, we can't have it both ways. If you're going to stick to the cost-based pricing, if it costs you nothing to provide the service, then how you going to...the costs you were charging for it? In this instance, if it's not costing you anything, we ought to take that from that and not charge anything. Since you're moving towards cost-based pricing, it's my understanding, that cost-based pricing means just that. And while I disagree, to some extent, with the cost-based pricing method, how can you on one hand want to charge the folks for something that's not costing you anymore--then you want to charge them more than it's costing you to provide that service. And in other instances, you want to charge them exactly what it is. When it raises the price, you want to charge them. When it lowers the price, you want to leave it as it is, is what you're telling us. And that doesn't make sense. That doesn't sound fair to me.

MR. JAMIESON: I didn't understand the last statement. But to the deg...

ASSEMBLYWOMAN MOORE: Well, let me make it clear to you. In the instance of touch-tone, you're telling me that there was a charge for it and while it doesn't cost anymore, given the switch system that you have, you want to leave that cost there. But you want to shift other costs to the ratepayer, because they're not paying their fair share. And I'm saying, let's not have it both ways. If it doesn't cost anything, then you ought not be charging them on that basic service...you ought not be charging them for the residential touch-tone service.

MR. JAMIESON: Of course, touch-tone does cost something to provide.

ASSEMBLYWOMAN MOORE: It costs more than rotary?

MR. JAMIESON: I'm not certain of what the exact cost breakdowns are...

ASSEMBLYWOMAN MOORE: Everything that I've seen, and I've seen studies that tell me that it doesn't cost more than rotary...but you're charging more than rotary right now.

MR. JAMIESON: Touch-tone is one of the services that has provided contribution to keep basic rates low...

ASSEMBLYWOMAN MOORE: I understand that. But that's not the point. The point that I'm making is that you keep talking about cost-based pricing. Cost-based pricing is charging the cost that it takes to provide the service. And in one instance, we're talking about a service that costs less than it's being charged at this time. In other instances, you're saying that the services that residential ratepayers are paying are not paying their fair share, and you want to raise it.

MR. JAMIESON: No, we don't. We have not said that.

ASSEMBLYWOMAN MOORE: You're not shifting costs to make sure that they pick up the cost?

MR. JAMIESON: We have said that we would freeze residents rates at this time.

ASSEMBLYWOMAN MOORE: I understand that and your flexibility...

MR. JAMIESON: And in fact...

ASSEMBLYWOMAN MOORE: No, no, no, no, no, no. No, no. Let's not go totally to flex...All I'm saying, all I'm saying, is that if we're going to go to cost-based services...you're saying your freeze is for three years and then you'll raise it to whatever it cost to pay it in three years. Fine.

MR. JAMIESON: That's...

ASSEMBLYWOMAN MOORE: But the point that I'm making is still, I guess it is still the same point, let's not mix apples with oranges. If it doesn't

cost anything...if it doesn't cost anymore than rotary service to provide touch-tone service, then let's not deduct that from the money that you owe the ratepayers, for the overcharges. That's what you're telling me you want to do, in this instance.

MR. JAMIESON: No, that's not what we're saying. What we're suggesting is that the rate for touch-tone be eliminated. That will mean that Pacific will receive...

ASSEMBLYWOMAN MOORE: You're saying that that constitutes a reduction in the cost, because you're knocking that out, that would take up some of the money that you're supposed to reduce the services by, and you'll reduce it accordingly by that amount. Is that correct?

MR. JAMIESON: What we have said is, that what we proposed in Phase II probably amounts...

ASSEMBLYWOMAN MOORE: No, don't tell me what you said...

MR. JAMIESON: ...amounts to more than we would give up under the normal process. And whether those rates are reduced on touch-tone or reduced somewhere else, it still amounts to reducing an amount of revenue...

ASSEMBLYWOMAN MOORE: I guess we're...I guess we're not communicating. You can't reduce something that people already are overpaying, and I guess that's the point I'm trying to make. And I won't...

SENATOR ROSENTHAL: Yes, basically what she's saying is that you have been charging for something, which has not been a cost and therefore you ought to return that, for the length of time that you've been charging it. And that...

ASSEMBLYWOMAN MOORE: I think he knows what I'm saying.

SENATOR ROSENTHAL: ...and that by saying, you know, that you're going to include it in the service, you aren't giving anything.

ASSEMBLYWOMAN MOORE: That's right.

SENATOR ROSENTHAL: That's really what it's all about.

MR. JAMIESON: Senator, the entire revenues in the whole schedule of rates is designed to, for Pacific, to recover its revenue requirement. What we're suggesting is, that we reduce the amount of revenues that we receive by reducing the rate for touch-tone. Touch-tone today provides contribution to keep basic rates low, just as toll services do. Many services are priced well below their cost, resident services are, business services are, private line services are, for the most part. A few services are priced well above their costs, such as toll, such as touch-tone. On balance, the revenues

that Pacific is allowed to charge, are supposed to equal its revenue requirement. What we're suggesting is that, Phase II, our proposal we will wind up...we're proposing giving up more revenue than would be under the normal attrition process.

SENATOR ROSENTHAL: O.K. Let's move on.

ASSEMBLYWOMAN MOORE: Absolutely.

SENATOR ROSENTHAL: Mr. McCallion.

MR. TIMOTHY J. McCALLION: Good morning, Mr. Chairman, Assemblywoman Moore. My name is Tim McCallion, and I'm GTE California's External Affairs Director. I appreciate being invited to this public hearing, to discuss my company's proposal for an alternative to the current cost of service regulatory framework.

ASSEMBLYWOMAN MOORE: Say that again. (Chuckle)

MR. McCALLION: Last December 1st I presented to this Committee, GTE's proposal in the Public Utility Commission's investigation. Since that time a decision...

SENATOR ROSENTHAL: By the way, you are going to paraphrase, we're not going to have you read this whole statement.

MR. McCALLION: Yes, I will.

SENATOR ROSENTHAL: Thank you.

MR. McCALLION: Since that time, a decision has been issued in Phase I of that investigation, in an ambitious schedule for filing testimony and holding hearings for Phase II has been established. Although our company did not appeal the hearing schedule to the Commission, we are gratified that Commissioner Wilk announced this morning, a delay in two weeks in beginning the hearings. At the prehearing conference, GTE California had supported the November 29th start date, as the appropriate date to start the Phase II hearings. I'd like to point out to Members of this Committee, that while our company supported the Phase I settlement, we believe the pricing flexibility should be permitted for more services in Phase II of the regulatory framework proceeding, and that is covered in our proposal. The Phase I order only accounts for approximately services which encompassed 2.8% of our total intrastate revenues. So, it's a very small portion of our revenues, which in fact, are covered by that settlement. I'd also like to emphasize that our proposal does not request deregulation of any service whatsoever, which is currently regulated by the Public Utilities Commission. I agree with Pacific Bell, and also with

Commissioner Wilk that there has been a misunderstanding, in that regard, on the parts of many people. But on close examination of our proposal which shows that we, in fact, are not proposing any deregulation of any network service that the Commission currently regulates today.

ASSEMBLYWOMAN MOORE: Are you saying, that a mistake was made in regard to General Telephone, or a mistake in regard to both General Telephone and Pacific Bell? I'm sorry I missed...

MR. McCALLION: Based upon my review of Pacific Bell's proposal, it's a mistake in regards both to our proposal and that of Pacific Bell. We are both proposing that the Commission continue to have regulatory oversight, over all of our network services. To summarize what we're proposing, as far as the way in which our services are regulated, we're proposing to divide our services into two categories. The first category would consist of basic services, and those would continue to be very much regulated by the Public Utilities Commission. And we are proposing, not a rate freeze, but a revenue cap for those particular services. And that is, we would propose that are prices for those services, the overall revenue that we get from those services, not be allowed to increase anymore than a predetermined index. And that index would consider inflation in the general economy, productivity in the general economy, with an adjustment made to recognize that productivity in telecommunications has been increasing at a faster pace, than what productivity has been increasing in the general economy. Therefore, if the productivity improvements that the DRA has alluded to, Commissioner Wilk has alluded to, continue in the telecommunications industry, that would be reflected through rate reductions or rate stabilizations for services within category one. However, I'd like to point out that that is a revenue cap. We feel that there needs to be some rate adjustments for the services that we have within that category one service, that category one, category of services. Right now we have many services in that category which are priced below the cost of providing service. We also have many services such as intraLATA toll service and access service that are priced significantly above the cost of providing that service. What we are proposing to do is rebalance that, so that we can move the rates closer to cost, to the actual cost of providing service.

ASSEMBLYWOMAN MOORE: Can I ask a quick question?

MR. McCALLION: Sure.

ASSEMBLYWOMAN MOORE: And I guess Bruce you might want to jump in as well. I just want to know, what's left when you say that it's not deregulation?

It's..in your instance, it's the price cap for...what is it a three year period as well?

MR. McCALLION: No, it's not a price cap. It's a revenue cap.

ASSEMBLYWOMAN MOORE: O.K. A revenue cap, o.k., a revenue cap, right. All right and it's a residential freeze for you, for three years, right? All right, now, which means that the PUC won't...will set that aside and won't look at that, unless there's a complaint about the quality of service, right?

MR. McCALLION: Under our proposal, the PUC will still look at the revenues we charge for those particular services, for two purposes, 1) to determine...

ASSEMBLYWOMAN MOORE: As long as you're within that revenue framework, revenue cap, they don't really pay much attention, right?

MR. McCALLION: They would not have to look at us in the detail that they have to look at us today.

ASSEMBLYWOMAN MOORE: I mean you wouldn't want it if you didn't have flexibility within a cap, right?

MR. McCALLION: Within that category the Public Utilities Commission would look at the index to ascertain that we have properly calculated the index for either increasing or decreasing our revenues from that category. In addition, as we rebalance rates based upon competitive market conditions, changes in technology, the Commission would look at the filings just like they look at advice filings and application filings today, that we would submit to the Commission for that rebalancing.

ASSEMBLYWOMAN MOORE: How does that differ from what I just said?...in terms of the role that the PUC will play? I let you Mr....Russell was over here yelling to let you finish and you said exactly what I said you said. I guess the point that...what I'm trying to get at is that I really want to get to what they're not going to be looking at, in the sense that you've got your ... you know the concern with residential ratepayers is met, by setting certain whether it's the revenue cap or the residential freeze, the...it sort of set aside from what the normal process...what is it that the PUC won't be looking at? Where do you have the flexibility to do other kinds of things that you can't do? Why don't you just kind of...can you just tick off a list for me on what they won't...what about capital outlay?

MR. McCALLION: Under our plan it will not be necessary for the Commission to look at capital outlay.

ASSEMBLYWOMAN MOORE: How about capital outlay?

MR. JAMIESON: Well, Pacific has proposed that we believe that the network in California needs to be upgraded over the next several years and want the Commission to also affirm that they believe that should be done.

ASSEMBLYWOMAN MOORE: I mean, but will they be looking at your expenditures in the same manner that they do now on your capital outlay?

MR. JAMIESON: What we have proposed for monitoring is that the Commission still retains full monitoring of all of Pacific's operations, both its financial operations and its service provision operations. Should they choose to do an audit-- they always have that option.

ASSEMBLYWOMAN MOORE: They always have that option anyway.

MR. JAMIESON: That's right and that's not going away.

ASSEMBLYWOMAN MOORE: But I guess...I guess the point is that they're not going to review it in the same manner that they do now.

MR. JAMIESON: Well, we believe that the proposal, to some extent, provides incentives and risk...

ASSEMBLYWOMAN MOORE: How about yellow pages? I'm just jumping around a little.

MR. JAMIESON: I'm not certain of the question, as it relates to yellow pages.

ASSEMBLYWOMAN MOORE: Never mind. Because, I mean, you're going to give me long answers on every one of them, if I tick them off. But we all know that the big ticket items are not going to get the same scrutiny under your flexibility plans, that they currently get. And I guess that's one of the real concerns that I have...while it's not deregulation, it is a departure from the scrutiny that some of the big ticket items that ratepayers pay for, won't be given the same scrutiny that they currently get. And I could go down a whole litany of those kinds of items, and you'd give me the long answer that doesn't quite say...you know, that doesn't make it clear. So I won't continue down that path. And I guess that's just a real concern that I have in terms of where the ratepayers going. While it's not total deregulation, it certainly is a departure in the scrutiny on some of those big ticket items that perhaps should be more closely watched. I'm not saying that they need to be watched to the same degree that they are now and that some flexibility may be warranted, but the proposals, I do have some concern with.

SENATOR ROSENTHAL: Will you continue please, and you have a couple more minutes.

MR. McCALLION: We also have a second category of services under our plan, which is comprised of non-basic services. Many of the same services for which pricing flexibility was granted in Phase I of the OII and we would propose that we be permitted pricing flexibility for those services. Pricing flexibility under our plan for those services, however, would not be limited to downward only pricing flexibility. We also propose that we have the ability to increase prices up to 10% per year for those particular services. If in fact the market place would permit us to do that. The limitation on downward pricing flexibility would be the relevant cost floor. Where the relevant cost for that particular service and before we could exercise our price flexibility we would propose that we would file those cost floors with the Public Utilities Commission for their review. That is not significantly different than what was in the Phase I order. We do feel, in response to Assemblywoman Moore's question, that our plan contains safeguards which will reduce the need for the Public Utilities Commission, on an after-the-fact basis, to go back and look at us on an account-by-account basis. First of all, we just had a rate case where the Public Utilities Commission did look at us on that specific type of basis. And I'll give you some examples. They went to our offices and looked to see how long it took a directory assistance operator to handle a particular call. They looked at the level of wage increases that we had in our contracts with our union employees. We believe that that level of scrutiny will not be necessary under our plan. Because the starting point for our plan would be the current rates that are in effect today, with all of the adjustments that have already been made. And then from that point, we would go to an index system, which would control the amount that we would be able to increase or decrease our revenues. To the extent that that system resulted in very good earnings for the company, we would propose that that level of earnings be shared, above a benchmark rate of return, between the shareholders and the ratepayers. So that the ratepayers would get benefits of any further productivity improvement that the company made, above and beyond what's automatically built in, in the index in our plan. And we feel that that type of a system is superior to the current rate case process which is going on today. Certainly an example of how tedious and how long this rate case process lasts is our 1988 rate case. We filed that case in January of 1987; we received an order in late August of this year, which resulted in a \$330,000,000 rate reduction, and there's still some minor aspects of that rate

case which have not been closed out yet. So, certainly, some improvement can be made in streamlining that process. I'd also like to point out, that one thing that the DRA in their comments, and other people forget about, this is not a new phenomena. Our 1984 rate case, which was supposed to have been implemented on January 1, 1984, in fact, didn't get a final rate decision until July of 1984. So, both when there's price increases and there's price decreases, the current system somewhat drags out the process, just because of the level of detail that is involved in it. What our plan is, is to streamline that process by putting more responsibility on the shareholders for performance of the company, and in return giving them an opportunity, if they manage that very well, to increase their overall earnings. I'd like to close with one other remark. An enhancement that we made to our plans, since I testified before this Committee last year, is that we now target efficiency credits to basic network connections. The reason for that is, that we are proposing to sustain to the extent we possibly can, the relative rate levels for our single line business and residence customers. We feel that this will help to minimize the upward pressure on rates while we're in an environment of rebalancing our rates and while we're in an environment where the cost of providing service is coming down. But that is a change to what we had made in our proposal last year. Thank you.

SENATOR ROSENTHAL: Thank you very much. I'd like to welcome to our Committee hearing, Assemblywoman Teresa Hughes.

SENATOR RUSSELL: Mr. Chairman, I think I owe my colleague Ms. Moore an apology for my interjection. I think it was done in bad humor. I'm shocked at myself. I normally don't do that and I just publicly want to say I'm sorry, Gwen; it was inappropriate.

ASSEMBLYWOMAN MOORE: It was the excitement of this testimony that made you do it, I know. (chuckle)

SENATOR RUSSELL: It's that, plus the difficult issue of trying to find out where truth is too. So, I do apologize.

SENATOR ROSENTHAL: Well, let me...thank you very much.

How does General feel about Pacific's proposal to open up the intraLATA competition?

MR. McCALLION: At this time, we don't believe that it's appropriate for the ban on intraLATA toll message competition to be lifted. We acknowledge the inevitability of intraLATA toll competition, however, we feel strongly

that prior to the advent of additional competition for intraLATA toll services, that the intraLATA toll rates have to be adjusted to be more closely aligned with the costs. I'd like to emphasize that while we accept, and while we are not opposed to the eventual opening of the LATA for additional competition, we feel that this cannot be done with the rates that we have in place today. That there needs to be an adjustment made to the rates, so that we can compete fairly with the interexchange carriers, in that market place.

SENATOR ROSENTHAL: You don't want to rush it, because you're not ready, in this case.

MR. McCALLION: In this case we aren't ready. Our company has not had a rate design since 1984. Certainly, the rates that were put in effect in 1984, don't permit us to compete in that market place today. When the rates are adjusted, we are more than willing to compete in that marketplace.

SENATOR ROSENTHAL: OK. I just wanted to throw that in, because you seem to be in a hurry for everything else.

ASSEMBLYWOMAN MOORE: I have a quick...

SENATOR ROSENTHAL: Anyway, we'll move on now...

ASSEMBLYWOMAN MOORE: ...Can I have one, just one quick one...

SENATOR ROSENTHAL: About what?

ASSEMBLYWOMAN MOORE: About one-year rate cases that would do exactly the same kinds of things that would rid us of Saturday...What is it Monday mornings...Saturday is before...Sunday morning quarterbacking, you know...

SENATOR ROSENTHAL: Monday morning.

ASSEMBLYWOMAN MOORE: Well, Monday morning, O.K. Monday morning quarterbacking...guessing, second guessing what decisions were made about what. If we could move into...rather than going through all the new regulatory reform kinds of activities that you are proposing-- a simple opportunity for you to make the same case, most agencies, most businesses, everybody else runs on a budget, an annual budget. Certainly it would appear to me that more and more ...that's poetic justice...more and more when your rate case becomes...it looks like a better idea. Do you agree?

MR. JAMIESON: No. You talked earlier about whether or not there's...

ASSEMBLYWOMAN MOORE: You've already answered by question. I told them I'd be brief. You said no. What about you?

MR. McCALLION: No.

ASSEMBLYWOMAN MOORE: What about you? No?

MR. ROSS: I'd have to agree with you.

ASSEMBLYWOMAN MOORE: Oh, see I like that, I'm ready for Barry Ross.

SENATOR ROSENTHAL: O.K. Next witness is Barry Ross, the Executive Vice President of the California Telephone Association. Welcome.

MR. BARRY ROSS: Mr. Chairman, Chairwoman Moore...

SENATOR ROSENTHAL: Mr. Ross let me remind you also, about ten minutes, give us time for the questions.

MR. ROSS: Fine. Thank you very much. I'll try to abide by your wishes. In deference to Mrs. Moore's statement about being exciting testimony, I'll make mine "calm downed" and keep it pretty sedate. (chuckles).

If you will, if you would just step down considerably in the thought processes that you have, because we're now talking about some very small companies that are on the... within the State that provide telephone service and it's these companies that I'm representing here today. There are twenty-two companies within the California...within the State of California providing telephone service. And with the exception of PacBell and GTE California who are here today, I will be discussing some of the views and concerns of the others. These range in size from Contel which is headquartered over here in Victorville, California, all the way down to the smallest which is up near Monterey, California, that has a total population, or a total access count of a hundred stations. As you know, these regulatory review processes are of concern to our people. We have many companies that...who maybe don't have the capacity to be involved...certainly to the extent GTE and Pacific Bell are, but that doesn't make them any less interested in what their potential impact is. Because the larger the impact...excuse me... the smaller the company, the larger the impact. I will state early that because of our differences in size, our companies have quite a bit different perspectives about what is going on. As I mentioned, there are some varying sizes in our companies, even the ones ...the limited number that I'm representing today. Contel represents, roughly three hundred thousand access lines, and the smallest one, as I said, has a hundred access lines. And we think that because of that, that there needs to be some consideration for the varying sizes that are impacted by these proceedings. One of the important aspects that's been touched on, certainly by Commissioner Wilk and by others in this proceeding is, that the agenda and the timeframe that the Commission has set, may be a little bit too tight. We will agree, and I think that most of the companies will agree, that there should be full...excuse me...a full time allowed, to consider and to respond

to all the issues that are present. At the current time, we don't have all of the impacts that are going to be...that are going to come out of even Phase II, and certainly Phase III is another...an all together different issue. The companies that I represent, have adopted at face-value the mutual goals that have been reiterated by the Commission. These are universal service, and here let me state that that's universally available, as well as universally affordable service, encouragement of the technological advances that are being introduced into our industry, financial and rates stability and then low-cost efficient regulation. Now, our past actions and our future actions, those of the companies...have been predicated on similar customer oriented goals. And we expect to continue those types of goals. We believe, with unanimity that no matter what form of regulator flexibility is permitted for the larger companies, the plan must be thoroughly examined to impact... to determine the impact on rural, as well as, the urban ratepayers. That's our first matter, or first issue. Second, that this impact be quantified before implementation. Third, that these companies believe that there should be an equality of basic service offerings between the urban and the rural telephone companies. And, finally, that the rural companies be assured through whatever appropriate revenue mechanisms, that their financial stability be assured to achieve the promises of the information age in there service areas as well. Having stated these common positions among the twenty companies, I'll digress just a little bit and share with you some of the views of the individual companies, because they do spread just a little bit from these common, common goals.

Roseville Telephone Company, which as you know, just north of Sacramento, and is one of the faster growing companies, believes that it should be permitted to continue with rate of return regulation for basic services. It believes it has done a good job and it can continue to do a good job under that type of regulation. Further, it believes, it should have the opportunity to price its non-basic services to meet competition, without undue regulatory restraint. It also believes that the Commission must make sure that these companies, the small companies and their customers are protected from adverse revenue impacts and rate shock during any experimentation with regulation of the larger companies.

There is a group of eleven companies that have gone together to make a filing before the Commission, in Phase II, and they have identified three

goals for their small companies that they have outlined. These are the continuation of the toll and access charge full procedures -- these are very vital to the small companies; policies which promote full participation by the small rural local exchange customers in technological developments, which we have mentioned earlier; the maintenance of the Commission's regulatory policies which afford the small company ratepayers the benefits of rate averaging with urban ratepayers through the California high cost fund. Another filing before the Commission is that of Contel who I...the company which I had mentioned earlier...they do not believe that at the current time that the revisions and the regulatory approach to the local exchange business can be developed, certainly not until Phase III is considered.

Still another group of six small companies reiterate that any alternative proposal must properly account for its impact. And they suggest that a compelling showing that the public interest would be served, should be required to justify departure from rate-of-return based cost of service regulation. So, you can see, based on that there is some diversity within the telephone industry itself.

Citizen's Utilities, which is headquartered in Redding, California, suggests that six safeguards to insure fair treatment for the small companies -- this is protection of the local exchange carriers franchise area is their first; application of new rate-making concepts, only after they've been tested by the larger local exchange carriers; an affirmation of the Commission's commitment to universal access, to all services; a comparability to enhancement; to basic service; and the expansion of the California high cost fund to all revenue requirement deficiencies. These, as I said, were representatives...excuse me...positions of the Citizen's Telephone Company. As you can see from our comments, the changes that will cause the most harm will be the introduction of intraLATA competition and the dissolution of pooling arrangements, and both of these are phase III issues. So we don't see in Phase II the tremendous impact that we're watching for in Phase III. And now Mr. Chairman, I'd like to turn to a more serious problem within my testimony and it has to do with the position filed by the Division of Ratepayer Advocates. And in their report titled "The Report on Alternative Regulatory Frameworks for Local Exchange Carriers, Phase II" which was submitted on September 19th, there's found a statement that we who are involved with small telephone companies found to be alarming. In discussing their proposal for interLATA competition, and noting that the probability of the

average toll rates and elimination of pooling arrangements and the high cost fund, the author commented on the future viability of small companies with the following statement: "As an alternative to augmenting the high cost fund, DRA would encourage the larger local exchange carriers to consider buying out those smaller local exchange carriers that are not able to operate viably." That's found on page 617 and 618. I recognize that this statement has come from the staff and not from the Commission itself, and it may not reflect the feelings of the Commission. However, if this statement was intended for shock value, it may have succeeded. I'd be surprised if the small companies would give up the fight and allow themselves to be bought out by the larger companies. They've got too long of a history of providing quality service to allow that to happen. This statement may have reinforced the small companies resolution to follow the Latin admonition "nil bastarde caparandum."

In summary...

SENATOR ROSENTHAL: So you want to describe that? (chuckles)

MR. ROSS: That roughly translates to don't let the bastards wear you down.

In summary, we in the telephone industry, and especially the small companies, and the providers of local exchange service, believe we have a healthy system. We believe we have leadership within the industry that's concerned and is willing to be involved-- that they're committed to providing the state of the art telecommunications services at attractive and affordable rates to all of their customers, not just the urban, not just the rural, but to all business and residential.

And finally, while we see the problems on the regulatory horizon, we believe that a solution is possible. And it can provide regulatory flexibility needed by the larger companies, and yet will assure the viability of the small and the medium companies.

Thank you Mr. Chairman.

SENATOR ROSENTHAL: Thank you. Any questions?

ASSEMBLYWOMAN MOORE: My last...I have one last question, I just wondered what's the benefit of all this to the people? I mean of the regulatory reform ...what are the people that elect me to the Legislature, my constituents, and Senator Russell's and Senator Rosenthal's and Assemblywoman Hughes', what are our folks going to get out of all this?

MR. JAMIESON: Want me to go first? Well, first of all, as Commissioner

Wilk mentioned relative to the...

ASSEMBLYWOMAN MOORE: I wasn't here for his testimony. So you just...

MR. JAMIESON: ...relative to the flexibility in Phase I, to the degree that that allows, in specific product flexibility, allows the local exchange companies to compete with other competitors and, in fact, results in the local companies retaining business that they'd otherwise lose. There's contribution flows to help keep basic rates low. To the degree that that system is put in place that relies on incentives and risks to the business which encourages even better and better performance, and has a mechanism for sharing that, it's a situation where both the company and the customer wins.

That wasn't too long.

ASSEMBLYWOMAN MOORE: But I have an hour's worth of rebuttal for it. But I'll...we'll have to talk outside.

You say ditto?

MR. McCALLION: My response is very similar to Mr. Jamieson's response, in that we do feel, with streamlining regulation will reduce the overall cost of regulation, which ultimately results in lower rates. We feel by streamlining the process, we'll be able to bring to services...

ASSEMBLYWOMAN MOORE: Does that...when you say streamlining...

MR. McCALLION: ...to the market place much faster.

ASSEMBLYWOMAN MOORE: ...does that mean that you guys are going to fire a bunch of attorneys, and a bunch of economists, and a bunch of other folks that, three to one...you mean it'll be one to one, now, from now on?

MR. McCALLION: Assemblywoman Moore, I don't believe GTE California has three to one ratio with the DRA.

ASSEMBLYWOMAN MOORE: Someone's holding up two fingers. (chuckles) So, it's two to one for you, three to one for PacBell.

MR. McCALLION: Definitely as our...

ASSEMBLYWOMAN MOORE: If it's half of one to one for the little telephone companies...

MR. McCALLION: Definitely as our company is streamlining its cost structure, we are reducing people in the regulatory area, as well as other areas within the company.

ASSEMBLYWOMAN MOORE: Well, you guys sure like to talk...long time. All right.

ASSEMBLYWOMAN TERESA HUGHES: That's why they're the telephone company. (chuckles)

ASSEMBLYWOMAN MOORE: Terry said it's in your best interest.

ASSEMBLYWOMAN HUGHES: That's right.

ASSEMBLYWOMAN MOORE: Telephone companies.

SENATOR ROSENTHAL: Thank you very much. We'll next hear from the Consumers/Competitors panel. Sylvia's already spoken...Michael Morris, Ken Mc...

ASSEMBLYWOMAN MOORE: A consumer? (chuckle)

SENATOR ROSENTHAL: John Ayers, John McDonald, Ken McEldowney. O.K. We will start right to left again. Michael Morris, Vice President, California Cable Television Association...let me mention to each of you, you have ten minutes, and then give us opportunities for questions. Your testimony... while more extensive, will be entered into the discussions here. O.K.

MR. MICHAEL MORRIS: Thank you very much, Senator. I'm Michael Morris, California Cable Television Association. I appreciate the opportunity to talk to you here today and, as you know, I never come up and read testimony, but I prefer just to kind of be free wheeling. I do ask your indulgence today to let me refer to my notes a little bit more than usual because a lot of the points I'm going to be making, have to do with quoting language out of PUC proceeding that we're talking about. Because the points I have to make are procedural, and there has been a tremendous change in the direction of the proceeding, and I'd like to make that point through, referring to different material.

SENATOR ROSENTHAL: Well, you may refer, but you have ten minutes. (chuckles)

MR. MORRIS: Thank you very much. This here is a very important proceeding because it's important not only...

ASSEMBLYWOMAN MOORE: If you say something new I'll hold up two fingers, that means two more minutes. (chuckles)

MR. MORRIS: ...has great impact on the California economy. Not only for the provision of the telecommunication services, but also having to do with the impact on the growth of jobs, technical development, and the explosion of entrepreneurial start-ups, such as a chip manufacturers, computer manufacturers, both large and small in California. And there's, as in every proceeding such as this, there are buzz words, and I think modernization is one of them. And modernization, I'm afraid, you have to kind of skeptically view as a code word, perhaps, for building the intelligence into the network in order to, perhaps, foreclose the market for innovative job producing California industries that would develop to actually put that intelligence on edge of the network. That's the impact, type of impact, that we really foresee

falling out of this proceeding. CCTA is interested, because our members are large users of telephone services; they're potential providers of competitive intraLATA private line services, and because, just as this will continue the framework under which telephone companies may improve and modernize their network to compete with terminal equipment manufacturers, it will also result in rules by which they may improve their plant, to provide competing video services. And given the historic, anti-competitive behavior of the telephone companies towards cable operators, we are interested in developing a system that is fair and balanced, and leaves no room for a repeat of the type of shenanigans involving cross-subsidization and other competitive actions involved in telephone competition with cable historically. This proceeding started in November of 1987, with the Commission's order instituting investigation. The Commissioner set out a "roadmap" for what they called an expeditious, yet thorough examination of the issues. And the Commission reflected in the OII and the testimony given at the earlier en banc hearing, and concluded that "the challenge for regulation, is to harness competitive forces for the benefit of all ratepayers, while taking special care to protect the interests of those ratepayers with the fewest options." And so they set up a phased proceeding, and they explained that as follows: that the proceeding involves careful synchronization of the various phases of the OII to insure that the parties receive the feedback they need from the Commission on some issues before the other issues can be addressed. They set out Phase I; Phase I was going to deal with pricing flexibility, and they recognized the following in their words, "Our ban on intraLATA competition creates a legal barrier to entry. We see the intraLATA competition ban as being closely tied to the issue of pricing flexibility." And thus they sought several things to determine; 1) how to tell if there is sufficient competition for a particular service, to justify pricing flexibility; 2) whether there are additional services that would be competitive if bans on intraLATA entry were lifted; and 3) what additional safeguards are needed to protect the ratepayers and the public, if pricing flexibility is granted. Again, this was a roadmap, as the Commission explained in their words; First, we will define the criteria for determining whether a service is sufficiently competitive to justify any flexibility. A specific services for which flexibility should be entertained, given the criteria and the type of flexibility which should be available. That was Phase I. Phase II was to deal with alternate approaches to rate-making for services not subject to competition. And Phase III was to deal with the ques-

tion of competition, only for intraLATA toll services. Now, this was a road-map, where each phase took us logically into the next. But the Commission almost immediately threw out that map, and has taken us on a wild ride, not from point A, to point B or point C, but has transported us, I believe, to point D, through some other route. Before the hearings in Phase I even commenced, the Commission adopted a private settlement, a settlement agreed to by only some of the parties. And this is very important, because I think the impression that's been given, is that everybody had signed off on this agreement. And that is not the case. This was not the product of a consensus. We very strenuously disagreed with that approach to the settlement, as did other parties.

ASSEMBLYWOMAN MOORE: But does that follow along my line, by invitation only?

MR. MORRIS: I think so. I think that's right. You know...I, I, I don't know if it's by invitation only, I think we certainly weren't in the loop, for getting our concerns worked in to the settlement process.

SENATOR ROSENTHAL: Ah, but you're not regulated.

ASSEMBLYWOMAN MOORE: Some of the other parties aren't either.

MR. MORRIS: Well, neither are the consumers. I mean this really has to do with the framework that affects everyone. The party...

SENATOR ROSENTHAL: PUC's logic was that you were not regulated, I guess.

ASSEMBLYWOMAN MOORE: No, but if you're a party to the proceeding and you're going to try to resolve it, then all parties ought to be a participant. And if you're going to talk consensus, if you don't have all the parties that have an interest, then you don't have consensus, and you don't have the kind of scrutiny, and you don't have a good agreement, if everybody hasn't been allowed...that's the whole purpose...the whole due process is to give everybody an opportunity to participate.

SENATOR ROSENTHAL: I'm not disagreeing.

ASSEMBLYWOMAN MOORE: Oh, OK.

SENATOR ROSENTHAL: I'm just saying, that that was their reason.

ASSEMBLYWOMAN MOORE: Oh, you...I thought you were being my straight person. (chuckles)

MR. MORRIS: It may be, and you know I think this idea of consensus, and who the parties are, really has come up again this morning with Commissioner Wilk, as to Phase II issues, and let me touch on that in just a moment. But the settlement, we believe, failed to do any of the things set out for it, in

Phase I. It did not determine what services are now competitive. It did not determine what would be competitive if the ban was lifted. And it did not determine a test for the presence of affected competition, that would allow price flexibility to be introduced. The Commission admitted this when they reviewed the settlement. They stated that the generic criteria to assist ...to assess competitive conditions, are left unaddressed. But they said that those issues would be rolled over into Phase II. Don't worry, we'll discuss those in Phase II. Phase I result was to give immediate flexibility to the local exchange companies, for the services they want to deregulate, while retaining prohibitions on competitive services the LEC's wanted protected. So rather than protect the ratepayer from cross subsidy, the stipulation actually, we believe, institutionalized cross-subsidy, by authorizing prices to go down to a floor, that failed to take into consideration administrative costs. There were no hearings on this issue. There were no hearings on any of these issues, and we are filing either today or tomorrow, I want you to know, a petition for review of the decision adopting Phase I, and that will claim that these problems have risen to the level of due process violations. Now, the Commission is going ahead with the implementation of Phase I. And we're troubled by this process of implementing Phase I at this time. For example, in order to see the cost data necessary for the local exchange companies to realign their rates, so that we can tell if the proposed rates are below cost, Pacific Bell has required parties, including ourselves, to sign a nondisclosure agreement. Now we have not yet agreed to sign the nondisclosure agreement they want us to sign. Because that nondisclosure agreement is very, very broad. It would not simply prohibit disclosure for competitive purposes, it would not prohibit simply disclosure of the data that they turn over, it would prohibit disclosure of any thinking, any conclusions that we come to as a result of seeing that data, it would prohibit us from sharing that conclusion, for example, with the Legislature. And I think this is an area where the Legislature may want to look into, this overly broad attempt to keep the Legislature in the dark, resulting from what the parties see in this proceeding.

ASSEMBLYWOMAN HUGHES: Question.

SENATOR ROSENTHAL: Assemblywoman Hughes.

ASSEMBLYWOMAN HUGHES: What kind of agreement...what kind of agreement would you be willing to sign at this point in time? Do you have specific recommendations?

MR. MORRIS: We have...Yes, we have countered with an agreement, confidentiality agreement, nondisclosure agreement, which has been used, has been agreed to by Pacific Bell in other...in other proceedings. It's a form that they have used in the past, we have said that that would be acceptable to us, they have said that that is not acceptable to them in this proceeding. Now, no sooner had Phase II started, then the ALJ ruled that no testimony would be taken on the competition issues. These are the issues that the Commission has just said, "Yes, they weren't resolved in Phase I; they will be rolled over in to Phase II." Now, they said, "No, we're not going to consider those in Phase II." So, while we're sympathetic to the Commission's goals, and we agree that some streamlining of the regulatory process is appropriate, rate cases need not take four years. We're concerned that the process, now in place, will put consumers and competitors at risk, by relaxing regulatory oversight without even the opportunity for parties to introduce evidence of effective safeguards along the way. For example, a key provision of Pacific's plan, would be to do away with the type of prudency review for investments that has resulted in the modernization proceeding of a staff recommendation to disallow \$700 million of investment by Pacific Bell. Yes, that's why they're in a hurry for this proceeding, because they don't want to go through that process again, they don't...that is the streamlining, that they're interested in doing. And it's these modernization activities, it's the investment activities which are really key, not only to consumers but also to the other infrastructure of other businesses in California. Commissioner Wilk stated this morning that rate of return regulation, results in perverse incentives. And we agree that in many instances proper incentive regulation would be helpful. But any change in the type of regulation and a move to incentive regulation, requires a consideration of methods for making sure that those incentives are correct. Those include some competitive safeguards, those include things such as ONA, Open Network Architecture, resale and shared use of facilities. The ALJ has specifically ruled that those will not be considered in Phase II, only the streamline regulation.

That does conclude my testimony, Senator. Thank you very much.

SENATOR ROSENTHAL: Right at ten minutes, thank you very much. Any questions?

OK. Ken McEldowney. Consumer Action.

MR. KEN McELDOWNEY: Yes. I welcome this hearing very much today, as...

particularly as the PUC thing begins to speed up unfortunately, even with the delayed thing. I fear that it's going to be a situation in which consumer groups such as Consumer Action will have to look to the Legislature for relief from decisions that may be coming down from the PUC. So we welcome this hearing as an opportunity on the part of you all in terms of getting information on the issue.

As you probably know TURN represents consumer action on many of the rate cases before the Public Utility Commission. So I think what I'd like to do now, is not sort of duplicate what Sylvia was talking about, but sort of talk about some additional concerns that we have, and also stress some concerns that she mentioned.

I think that the main thing that I wanted to say is that for some fifty-eight years rate-of-return regulation has worked, both for consumers and I think for the companies that are involved. We have not yet seen any indication from either the local operating companies or from the PUC that would indicate to us, that rate-of-return regulation is no longer working. I think that the ...that is the first test. We should not be making wholesale changes in the type of regulatory framework in California until we have some very solid proof that existing regulation is not working, and therefore needs to be completely dumped.

The second thing is, I wanted to stress what Sylvia said in terms of, that the hearings, and also a lot of other people including you on the Committee, is that Phase II is in fact a very important phase, and one that is very crucial in terms of history of tele...for the future of telecommunications in California. It's a very complex issue and there are many alternatives being considered, both actively and sort of indirectly from the other states. We believe that the Commission should take as long as possible to reach an intelligent decision on this, it's not something that should be rushed through at all. There's no rush, there is no need to rush.

Another point that I think needs to be stressed, and stressed again, is in fact the telecommunications is a declining cost industry. We're not talking about an industry that's seeing rapid increases and cost, as such, the rate freeze, as Pacific Bell is sort of holding out as a carrot, is no big deal. And I think consumers recognize that as a fact. For the most part, consumers are increasingly realizing there's a situation in which they should be getting lower telephone rates, not higher, or even a freeze.

The next thing I wanted to touch on, really, which I think is, hasn't been touched on that much, although the previous speaker did, is I think that one of the things Pacific Bell has done in terms of their California plan is wrap their whole request for regulatory flexibility in sort of a wrapping, so to speak, or an overcoat of an intelligent network. And one of the things they're claiming is that unless they get this regulatory relief, unless they're allowed to make the investment that they want to make, that in fact California residents are going to be denied benefits from information age. They'll be denied benefits from intelligent network. We go part of the way, in terms of Pacific Bell, but only part of the way. We believe that one aspect that is true, is that we believe consumers throughout the State should have the benefit of touch-tone service. It's, I think it's very surprising that General Telephone, which is always sort of considered to be in the backwater, has a much higher percent of their customers have access to touch-tone, then does Pacific Bell. So, I think that the one thing that we do agree with, the terms of Pacific Bell, is that the investment that's necessary to bring their customers up, having touch-tone capability, is probably an investment that's justified. If nothing else, it provides the ability to block 976 charges, which I think is a very serious problem and they say it continues to be a very serious problem. But I think that the other fact that needs to be stressed, is that once people have touch-tone capability, they already have the access to intelligent network. They already have the access to the information age. But we don't think that the additional investment of Pacific Bell wants to make, is something that will benefit individual, residential and business customers, and in fact, if Pacific Bell wants to do that, it should be coming from the investors, not from the individual ratepayers.

The next point I think I wanted to make is that we have not been overly impressed with some of the benefits so far in telecommunications, from deregulation, and from easing of the regulatory framework. The impact on consumers has been one that's led a lot of confusion. I think you can sort of lead through some of the things, inside wire, that was something sort of hoisted upon consumers, but there wasn't any sense of what the impact was going to be. There's deregulation to a certain extent, certainly there's competition in the long distance market, but we find basically the rates of the major carriers are almost identical for Sprint, MCI and AT&T, particularly in the fact that it's residential customers. Private pay phones, alternative operator services, are again areas that were held out as being

promises the benefits of competition, which have not proved to be the case.

976 and 900 are areas of Pacific Bell, that we...our scrutiny has proved themselves unable to deal with, even within a regulatory framework, we are very concerned about their ability to deal with that, as those new products come on line. The whole area, in terms of class products, which is something that they are going to be introducing this spring, which are a whole new range of things. One of the most...ones that we're most concerned with is one that will allow telemarketers to instantly know the phone number of people who have called them for information. We believe that there's a lot of need for continued oversight, for continued regulation on the part of the Commission. We believe we've seen no justification whatsoever for wholesale retreat from rate-of-return regulation. Thank you.

SENATOR ROSENTHAL: Any questions?

OK Mr. Ayers, Bay Area Teleport.

MR. JOHN R. AYERS: Thank you, Mr. Chairman, Members of the Committee. As with the other panelists, I'm pleased to be here to present the views of the Bay Area Teleport regarding the status of telecommunications competition in California and the current CPUC proceedings.

I have a prepared statement for the record, which I believe you've already received. There are three Bay Area Teleport perspectives I'd like to state at this time.

First, at this juncture in the OII, the Bay Area Teleport questions whether it is the goal of the State of California, as evidenced by the CPUC, to foster an environment conducive to meaningful competition. It's interesting to note that on the interstate level, the dominate carrier was held under strict regulation, while competition evolved. The CPUC appears to be advocating the reverse of that, an unfettering of the dominate carrier, at the expense of emerging competition.

Second, in the OII currently before the CPUC, due process, although mandated of the CPUC by the California constitution, appears to be unavailable to consumers and emerging competitors to the local exchange carriers.

Third, the only way that we believe that we can insure a level playing field for competitive telecommunication services in California, is to bring about the divestiture of all competitive services of PacBell. This is what the Bay Area Teleport has proposed, in its OII Phase II testimony, and what it believes will best serve all parties.

In conclusion, to protect telecommunications competition, and to preclude establishment of a de facto deregulated monopoly, it is incumbent upon the California Legislature to forcefully exert control over telecommunication policy, as we believe it's empowered to do. Thank you.

SENATOR ROSENTHAL: You have a separate filing for rate regulations before the PUC...do you claim a separate filing for rate regulation? You don't?

MR. AYERS: Not that I'm aware of.

SENATOR ROSENTHAL: You don't have a regulatory plan before the Commission?

MR. AYERS: We have a filing that proposes a divestiture, if that's what you are referring to, Senator, yes. It discusses the economic...

SENATOR ROSENTHAL: In this proceeding.

MR. AYERS: In this proceeding, yes.

SENATOR ROSENTHAL: Oh, o.k.

MR. AYERS: I thought you meant one for Bay Area Teleport.

SENATOR ROSENTHAL: No, no, no, no, no. Do you think your proposal will have adequate review of the Commission?

MR. AYERS: We question whether any proposal we present gets adequate review at this time. So, I would speculate that it will get reviewed. Whether it's adequate and meaningful, I couldn't say. But I doubt it.

SENATOR ROSENTHAL: Why?

MR. AYERS: I don't believe that the schedule will permit an adequate review. I'm not sure, that based on what Commissioner Wilk said a little earlier today, that the interesting proposals come from PacBell, General Telephone, and the DRA. There was no mention of other potentially valid and useful filings be made. I'm not sure there's a disposition to consider anything as radical as I mentioned.

SENATOR ROSENTHAL: O.K, if there's no further questions, we'll hear from Mr. McDonald, who's the Vice President, Associate General Counsel for Dunn and Bradstreet Corporation.

MR. JOHN P. McDONALD: I thank you for the promotion, I'm not with Dunn and Bradstreet, or at least not a Vice President of their's. I'm with Reuben H. Donnelly Corporation, which is a Dunn and Bradstreet company.

SENATOR ROSENTHAL: Oh, o.k., I'm...

MR. McDONALD: But if you'd like to make that recommendation, I'd be happy to...

SENATOR ROSENTHAL: I, I,...no. I stand corrected.

MR. McDONALD: The Commission's agenda is spelled out in the various orders detailing procedural requirements. The Commission has not indicated that it is, has already decided, that some form of rate stability, or incentive plan, is a necessary outcome of its proceedings. The Commission does appear to desire some different form of regulatory treatment, for what has been termed, competitive services, assuming that this can be accomplished in some legal manner. From reading the California Public Utility Commission's original pronouncements of this proceeding, as well as the plans filed by local exchange carriers, it may be concluded that the overall objective of the regulatory alternatives investigation is extremely ambitious. It is extremely ambitious in that the Commission is attempting to develop for Pacific, what was impossible over many decades to develop for the American Telephone and Telegraph Company. Specifically, the investigation is attempting to construct a regulatory framework for the governance of regulated telephone monopoly franchise activities, in adjacent to competitive markets, in a way which tests the interest of the ratepayers, i.e. avoiding cross subsidization of competitive activities, while prescribing anti-competitive behavior by the utility, i.e. preventing discrimination, leveraging of monopoly position into competitive markets, or refusal to deal. Just four years after the divestiture of AT&T, Pacific and General Tel, now contend that they find themselves in a position where they believe, that because of increased competition in certain segments of their business, they require a relaxation of regulatory controls which apply to them, in order that they may deal with these problems. Nowhere have the proposals made by Pacific and General Tel, indicated why their alternative plans were co-mingled, competitive and regulatory activities... excuse me...would work in the current environment, when they have not only been found to fail in a similar situation four years ago, but required the largest corporate reorganization ever, in order to remedy the failure. Experience has shown that regulatory frameworks for operating companies, having both competitive and monopoly services, are difficult to design at best.

Our observations, with respect to the proceeding, are as follows: An alternative regulatory framework that combines competitive and utility functions for regulatory purposes, would provide continual oversight problems for the California Public Utility Commission. Further, it is not clear that the marketplace has become sufficiently stabilized after the divestiture of

AT&T, to permit the prudent construction of such a regulatory framework.

Second, to the greatest extent possible, once a service is identified as competitive, a process requiring careful and continuing analyses, it should to the extent possible, be simply occurred in the marketplace with the same standing relative to the utility and its franchised functions, as any other participant in the marketplace. These services should be considered as divested from the utility operations and adequate compensation to the ratepayers, should be provided for the removal from the ratepayers portfolio.

Three, the remaining utility functions, i.e. those derived from the local exchange franchise, should be treated as monopoly and traditional regulation, including the obligation of cost base, nondiscriminatory, tariff service, should be applied to these services.

Fourth, the funding of competitive and regulatory sectors will continue to plague the Commission with problems of cross subsidization, anti-competitive practices, and potential insufficient protection for captive ratepayers, and incentives for improper conduct in the competitive marketplace. The overall conclusion is that a modified regulatory approach alone cannot provide a total solution to the problems facing the Commission and local exchange carriers. The regulatory alternatives proceeding may provide a good initial step by attempting to contain the conflicts, which will continually arise as a result of the interplay of monopoly franchises and competitive markets, short of the kind of solution adopted in the AT&T proceeding, in which substantial segments of the business were divested, with a hope of creating a utility confined to competitive interest and opportunities.

SENATOR ROSENTHAL: O.K., let me...let me ask you a question. I understand Dunn and Bradstreet requested that specific information be included in Phase II, and it was denied. Are you familiar...can you comment on your request?

MR. McDONALD: Yes, sir. Well, actually, we attempted to raise issues in Phase I, because we thought that our operation here in California, our yellow page operation, was in competition with the utilities. We were told that issues of competition from outside the monopoly into it were not an issue in this proceeding. And the...Phase II, we have filed testimony, testimony of Jim Madden, which addresses a broad range of issues.

SENATOR ROSENTHAL: Any questions? Any general comments on the DRA

report? Mr. Ayers.

MR. AYERS: There's one comment I'd like to make on that, and with it tie in to something that Sylvia Siegel said, and that was that the real key is the definitive cost study for any proposal, and that cost study has to be independent; it really cannot be done by the regulated monopoly. Cost are as costs are defined. And so long as the Commission has to rely on the definition of cost, coming from the utility, it won't be a successful study.

SENATOR RUSSELL : What is the, perhaps you Mr. Chairman or your staff could tell me, what is the general practice? Is it that the PUC accepts the costs that are provided by the utility? Is that what happens when the rate cases...doesn't PUC go in there and figures all this stuff out? What's the ...how does that work?

SENATOR ROSENTHAL: Why don't we hear from PUC.

MR. CARL DANNER: Carl...Carl Danner, Advisor to Commissioner Wilk. I think there are two census in which cost studies have been used here this morning, Senator. One is the sense of determining the total operational costs of the phone company for setting a revenue requirement. And the second sense ...

SENATOR RUSSELL: Who does that one? Who provides that information?

MR. DANNER: The telephone company makes a presentation to the PUC and then other groups such as DRA and interveners, vigorously contest that information.

SENATOR RUSSELL: On the basis of...just... basis of what?

MR. DANNER: The basis of various studies and audits, and investigations that they undertake, to determine what reasonable costs ought to be. Mr. McCallion gave an example this morning, the amount of time it takes an operator to handle a call. For example, an important determinate of how much money you need for operator services, which is one of the components of the cost that a telephone company experiences, that example was vigorously contested with DRA presenting its own study in the last general rate case in contrast to generals, and then other information brought in by other groups. So, those costs are vigorously determined...vigorously contested and then determined ultimately by the Commission.

SENATOR RUSSELL: Does the Commission have the authority to go in and look at the books, and do time and motion studies and whatever else, that

the...all that private information that a company has?

MR. DANNER: Yes, and those kinds of studies are a routine practice that DRA and others will undertake.

SENATOR RUSSELL: But, this gentleman, Mr. McDonald, no, not Mr. McDonald, Mr. Ayers, indicated that, I think when he said that that kind of approach would not be a fair assessment. Is that what you said, Mr. Ayers?

MR. AYERS: I think a fairer assessment would be one that is independent in nature. The basic data still is supplied by the utility, and the answers to questions or interrogatories are provided back by the utility. And certainly, the Commission renders judgment as to the validity or nonvalidity of the responses. So, I think an independent study would be far more useful.

SENATOR RUSSELL: When you say independent, then what does that mean to you? That they go in and do what the PUC now has the authority to do or what?

MR. AYERS: No, it would mean that an independent agent operating on the authority of the Public Utilities Commission would develop the data necessary to...just to show the cost in each type of service offered by the utility.

SENATOR RUSSELL: They would do that in place of the PUC?

MR. AYERS: But I don't think the PUC goes in now, except on a selected basis. It doesn't...I don't believe it has the resources to do a complete audit of the entire cost study provided by the utility.

MR. DANNER: Senator, if I might, I think this is speaking more towards the second purpose for which cost studies are used. Once the PUC has determined the overall revenue requirement in the current system, that a telephone company would need for a test year, there is the issue of rate design. And that's where we start talking about the goal of setting prices more in line with costs, and where we set explicitly some prices not equal to cost, either to further affordable rates in basic service or other services are set above costs, as was discussed earlier, to provide contribution to support that. I think that this is the area that Mr. Ayers would have more of a concern with, because Bay Area Teleport provides some services that are or could be in competition with some services that PacBell and General Telephone provide, and the issue becomes, both in terms of buying some products from PacBell, that they would use in competition or in competing with the prices PacBell is setting, whether those prices are appropriate and do reflect cost. I might call

the Committee's attention to one cost study that is underway, that may satisfy some of these needs. It's still in a preliminary stage. But General Telephone and Pacific Bell have issued a substantial grant together to the Rand Corporation to try to determine incremental costs of various telephone services, such as residential basic rates. And I think they're starting to get some preliminary results that may give us a better handle and may represent to some degree, anyway, this kind of independent cost study that some of the speakers have been calling for.

SENATOR RUSSELL: Is that type of thing what you're talking about, Mr. Ayers?

MR. AYERS: Yes, I'm not sure that an incremental cost study is what I had in mind, I was looking for a cost causer, cost payer kind of a study that would indicate where some of these were, in fact, taking place and where they are not. But certainly providing service at incremental cost is not something that I'm aware of that's been accepted by the Public Utilities Commission.

ASSEMBLYWOMAN HUGHES: Mr. Chairman, I'd like to ask the gentleman from the PUC, who chose Rand Corporation to do the study?

MR. DANNER: It was a culmination of...I guess kind of a long process of negotiation and discussion. The Commission had a substantial role in choosing the Rand Corporation. There is an economist who works in strategic planning division at the PUC who tried to stimulate interest in such a study. It was ...I'd say something of negotiation, because the telephone companies were putting up the money for the study. However, I would note that the gentlemen who are conducting the study for the Rand Corporation are among the most widely respected and well known telephone cost economists and they...

ASSEMBLYWOMAN MOORE: Is Leland Johnson involved in that study?

MR. DANNER: I believe he's involved in some of the review panels that are participating to review the study's results.

ASSEMBLYWOMAN MOORE: Well, he used to be the most reknown person to Rand, and did some of the initial early studies relating to deregulation with AT&T and the other kinds of things that...

MR. DANNER: Famous work, Johnson paper, yes. Richard Mitchell is the lead economist, along with Dr. Park on this study. And as I say, they both have outstanding reputations as independent quantitative economists.

SENATOR ROSENTHAL: Any...Any further questions?

ASSEMBLYWOMAN MOORE: But basically, among the deregulated community, right?

MR. DANNER: I wouldn't qualify their reputations. I think they're outstanding in all circles. And if you ask anyone who works for...

ASSEMBLYWOMAN MOORE: But basically, their work has been with deregulation?

MR. DANNER: No, I wouldn't agree with that. I...they...

ASSEMBLYWOMAN MOORE: Name me...cite me a couple other studies that they've done, that didn't relate to deregulation, its impact, and its benefits?

MR. DANNER: Well, one in particular, there was a quantitative study of local measured service that they recently completed. Looking at the actual economic efficiencies that one could expect from local measured service, given limitations on the number of pricing periods one could use and whether or not you could actually get more efficiency from charging different prices for local calls at different times, or whether you just want to make it free. And that's certainly applicable directly to a regulated...deregulated any kind of environment, as long as you have a monopoly of the telephone service. In fact, I think it's most directly applicable for a regulated environment.

SENATOR ROSENTHAL: Thank you very much. We will break for lunch. We will return...will return here at 1:45.

- - - - Lunch break.

SENATOR ROSENTHAL: I apologize...I pride myself on being on time and somebody arranged a lunch that was downtown, and you know what the traffic is like -- it's impossible.

Let me have the long distance telephone lobby group, Bob Stechert, Ann Pongracz, Mary Wand and Richard Frockt...and we will take the witnesses from right to left. Bob Stechert, Vice President, Regulatory Affairs, AT&T.

MR. BOB STECHERT: Thank you, Mr. Chairman. It's a pleasure for me to be here this afternoon. I am Bob Stechert, I'm Vice President, External Affairs with AT&T. And I have just a brief, few...sorry.

PATRICIA STEARNS: We can't hear you.

SENATOR ROSENTHAL: Let me request that the members of the panel, limit themselves to ten minutes. They may have longer presentations, which we will enter into the record, giving us an opportunity to spend more time on questions, as we did earlier this morning.

MR. STECHERT: Thank you. I just have some brief remarks to make concerning alternate regulation for the local exchange companies here in California, and just a few points. First, I would like to make a point, that AT&T agrees that there may well be better approaches to traditional cost of service regulation, for regulating the local exchange carriers in California. First of all, we believe, that there may well be a need to change the way in which the local exchange companies are regulated, to provide greater initiatives and incentives for them to manage their businesses economically and efficiently. Secondly, we also recognize that the regulatory process, as it's evolved here in California, has become extremely cumbersome. It's slow and ineffective. There are delays in the effectuation of rate changes and in producing reductions in rates to consumers here in California. And there may well be a more efficient way to accomplish what regulation is not accomplishing today. Finally, there is a changed environment, or a changing environment, as far as local exchange companies are concerned. They do face competition in some areas. And we believe that they need some flexibility to meet that changed competitive environment. However, I would point out, that as an inter-exchange carrier, AT&T does have some concerns which we believe must be addressed under any alternate regulatory scheme that might be adopted for the local exchange companies. And that...and those concerns really cover a couple of different areas.

First, we need to be assured that we will still be able to obtain reasonably priced facilities that we need to originate and terminate our long distance services for our customers. Those facilities, which we obtained from the local exchange carriers exclusively, connect our offices with our customers' premises, their homes and their offices throughout the State. And it is only the local exchange carriers who have these facilities and can provide them to us. It's, therefore, essential that those facilities be priced reasonably to us, so that we can maintain reasonable rates for the services that we provide to our customers within California. For that reason, any alternate scheme to cost of service regulation must provide a mechanism...or mechanisms to assure that the local exchange carriers will not reap monopoly profits in their provision of those essential facilities to the inter-exchange carriers.

Second, I would point out, that the prices that we pay today for these facilities between our offices and our customers homes and businesses are

currently priced substantially above the cost that the local exchange carriers incur in providing them. The California Commission adopted, a couple of years ago, a program, a plan to bring the prices for those facilities more in line with their economic cost. We believe that it is essential that that plan, that program be continued and that the prices we pay for these access facilities continue to be driven towards cost. In addition to these concerns, we believe that the local exchange carriers, because they control these essential facilities between our offices and customers premises, under any alternative scheme there must be a way to assure that the local exchange carriers don't use their control over those essential facilities, to unfair competitive advantages. They've got the essential facilities that connect up customers' homes with the services that their competitors offer, and so any alternative regulatory plan must assure that they can't use their control over those facilities to their competitive advantage and to the disadvantage of their competitors. We believe that mechanisms can be established to assure for that; that if the local exchange carriers continue to provide those essential facilities under tariff to their competitors, and if the prices that they charge their competitors are reflected in the rates they charge their customers for their unuser services, then the leveraging of those essential facilities to their competitive advantage will be minimized. Finally, we believe, that it's critical that under any alternative regulatory arrangement, the LATA's must be open to competition. Currently, the local exchange companies enjoy, as we heard this morning, an exclusive franchise in the provision of intraLATA service. We, as inter-exchange carriers, have services that we wish to provide our customers, that have intraLATA capability. And those services are services that our customers want, and need, and we want to be able to furnish them to our customers. So, we believe that the LATA's should be open to competition, and we should be allowed to provide services within the LATA's, in competition with the local exchange carriers. Now, if those general objectives can be achieved, then we believe alternate regulatory schemes for the LEC's can be workable and could, in fact, provide benefits to consumers here in California, beyond what we are currently seeing under traditional cost of service regulation.

SENATOR ROSENTHAL: Well, since you're agreeable to opening up the LATA's to competition, in what areas would your company compete, where it doesn't do so now?

MR. STECHERT: Well, Senator Rosenthal, we've been clear about this for sometime. We have services that have incidental intraLATA capability, where our customers, in using our services, might make some intraLATA calls. And currently, they can't do that. They have to use local exchange carrier services to place those intraLATA calls, and they find it very cumbersome and very difficult. And what we would like the opportunity to be able to do, is offer services so that our customers can use our services to make the calls both between LATA's and within the LATA's, so that they don't have to go to the local exchange carrier every time they want to place an intraLATA call.

SENATOR ROSENTHAL: Do you see this proposal as an attempt by Pacific Bell to enter the lucrative "long distance service"?

MR. STECHERT: Well, Senator, I don't believe that under the plan that Pacific Bell has before the California Commission, they've proposed to enter the intraLATA market via...I think as someone pointed out this morning, that's not something within the jurisdiction...

SENATOR ROSENTHAL: How about the future?

MR. STECHERT: ...of the Commission. Ultimately, I think the local exchange carriers would like to get into that business. But we have a consent decree that came out of the anti-trust settlement, between AT&T and the federal government, that currently precludes them from entering those markets, based on concerns that existed and continue to exist, about their ability to leverage their control over the local facilities to their competitive advantage in providing long distance service.

SENATOR ROSENTHAL: What's the status of the PUC's investigation to provide rate flexibility for AT&T?

MR. STECHERT: Senator, we just completed, about a week ago, hearings in that proceeding. The case is now before the ALJ. I believe that today we submit final briefs in that case. And the case will be ripe for decision by the Administrative Law Judge to make recommendation to the Commission, as a whole, as to whether or not AT&T receives some regulatory flexibility here in California.

SENATOR ROSENTHAL: I'll ask the same questions of the other companies, when you finish with your proposal. So, Mary Wand, MCI.

MS. MARY WAND: Thank you, Senator. I have a prepared statement which...

SENATOR ROSENTHAL: ...which you're going to shorten up to about ten minutes.

MS. WAND: Yes, I will.

SENATOR ROSENTHAL: Thank you.

MS. WAND: I will not bore you by reading it, you can do that yourselves.
(chuckles)

SENATOR ROSENTHAL: I hope that it will not be boring. Thank you.

MS. WAND: I will summarize it for you, however. MCI's interest in this proceeding in front of the Commission is twofold. First, however, we are a customer of the Local Exchange Companies in California. We are the second largest customer, both Pacific Bell and General Telephone. Roughly, half of MCI's gross revenues go to these two companies, in the forms of access charges. So we have a very strong financial interest from our perspective in terms of how the rates we pay are regulated. We're also here because we are a potential competitor, should the LATA be opened, which is a position that we believe. So we have two, two interests in this case. Let me state upfront that MCI does believe that certain...that the current regulatory structure in California for the LEC's is in need of revamping. And we have in this proceeding put forth our own proposal for a new regulatory framework for the LEC's. Before you jump to any conclusions, let me quickly anticipate your...your response there. We do not believe that moving away from cost of service rate making for the Local Exchange Companies is appropriate at this time. And I will summarize what our plan is, in a moment.

I think it's important to recognize that the telecommunications industry has changed an awful lot in the last four years. Changing hasn't stopped, but it has changed. Fringe competition is beginning to emerge for the LEC's it tends to be in the equipment and enhanced service areas. There is a critical aspect of Local Exchange Companies operations that hasn't changed though. They still have monopoly control over the local network. And that monopoly control gives them a tremendous amount of market power. And that needs to be recognized as we go forward in developing any new framework for the Local Exchange Companies. The plan MCI has submitted, we believe, is a reasoned and thoughtful response to the changes in the marketplace. Essentially, there are three...three major points to our plan. We believe that where competition can develop it should be allowed to develop. Restrictions on entry should be removed. IntraLATA prohibition on entry should be removed. The bottleneck facilities that the Local Exchange Companies offer, that the competitors must purchase in order to offer their services, should be avail-

able in a nondiscriminatory fashion, at rates based on cost. And as a quick example of what I mean by nondiscriminatory, it means adopting the philosophy that a loop, is a loop, and it doesn't matter who's buying it, what they're using it for, and whether or not this potential customer wishes to resell it. The cost of a loop should not vary. In addition, other network building blocks should be unbundled and available at the same price, terms, and condition to all customers, whether or not they're competitors of Pacific Bell, or Pacific Bell itself, or General Telephone. The Local Exchange Companies to the extent they're allowed into the competitive markets, should buy these essential building block facilities from themselves, just as the potential competitors must purchase them.

And, finally, cost of service regulation should not be abolished. It should be continued. But the focus of these reviews should shift away from the retrospective attrition type reviews that we see today, and should focus more on the costing and the pricing of these network building blocks. This would mean less attrition review, less strict rate of return review. But we believe that the protections for ratepayers against cross subsidization will be maintained by focusing the prices of the services that are available at cost. We believe that this plan will allow competition to develop where it feasibly can, without advantaging or disadvantaging any competitor more than any other competitor, and it will also protect against cross subsidization. Now, I want to emphasize that this plan is a procompetitive plan. However, it's important to realize that procompetitive plans do not mean maximizing the flexibility for Local Exchange Companies monopoly services. MCI believes that the Commission, in its haste to move forward on this...in this proceeding, has lost sight of the market power that the Local Exchange Companies have over the bottleneck facilities. Flexibility from monopoly services will not lead to competition. Granting flexibility prior to setting up a structure with rates based on costs and open entry, will harm the ratepayers and prevent growth of any competition. The market power that the local exchange companies will be able to leverage prior to any competition, will in effect, prevent any competition from developing. MCI believes that the Commission's current schedule, unfortunately, is going along this path of granting flexibility prior to a review and a decision on competition. We urged the Commission, in various pleadings earlier this year, to at least consider competition and intraLATA

entry at a minimum concurrently with their flexibility proposal. We, however, did not prevail on that issue. The Commission will review intraLATA competition in Phase III.

And to summarize, let me just state that we believe that our proposed plan will set up an industry structure that will be useful for many years to come; will allow competition to the benefit of ratepayers competitors; will allow Pacific to compete in markets where there is real competition, without being able to stifle this competition through its market power; and will be relieved of certain aspects of the current regulatory structure by setting rates on a perspective cost based basis, as opposed to a retrospective review of past operations. Thank you.

SENATOR ROSENTHAL: Would you explain why you think that competition would not be available through rate structure...flexibility?

MS. WAND: Well, granting the Local Exchange Companies rate flexibility does not force them to offer the bottleneck services that their competitors need on an equal basis. They have tremendous market power and to the extent that they can leverage that through flexibility, they can make it very difficult for a new competitor to enter the market who must buy, in order to operate one of those services.

SENATOR ROSENTHAL: In what areas would your company compete, where it doesn't compete now?

MS. WAND: Well, we would...the current ban on intraLATA competition has, in effect, made it very difficult for MCI to introduce certain interLATA services, that have intraLATA capability. As Mr. Stechert mentioned, not all services out there are solely inter or intraLATA. We have several services in California that are primarily intraLATA services, but should the customer choose to use their services for an intraLATA capability, they can use those services. This...the existence of this capability, in conjunction with the ban on intraLATA competition, has delayed the introduction of interLATA services. The lifting of the ban would allow us to go forward with new services in California. What comes to mind...these type of services I have in mind here are software design networks 800 services, services that you special, as opposed to switched access. The ban has put a restriction on our ability to offer them on an interLATA basis. We would be able to roll out new interLATA services without the cost of trying to live within the intraLATA ban.

SENATOR ROSENTHAL: In your opinion, why shouldn't the FCC lift inter-

LATA bans, if intraLATA bans are lifted?

MS. WAND: Well, that would take us back to predivestiture. The fundamental reason for divestiture was the...as I mentioned, the market power that was being exerted by the company that offered competitive services, as well as the bottleneck services. And the reason we had divestiture in the first place was because Ma Bell in those days was leveraging its market power and preventing the MCI's and the Sprints of the world from growing up, and becoming the companies that they are today. There's a fundamental problem which is very common in economic theory, that when a competitor of a service also happens to be the monopoly provider of the essential input to its competitors, you're going to have, you're going to have difficulty in competition growing. That situation hasn't changed. It continues to exist in...and it will exist in the intraLATA marketplace. Without the protections, without a thorough unbundling of the bottleneck facilities, without some technological advances that will remove the Local Exchange Companies ability to leverage its market power for essential facilities they will always have an unfair advantage of competition against the companies that must buy its services. That exists within the LATA, as well as...on an intraLATA basis.

MR. STECHERT: Senator, if I might just add a point here.

SENATOR ROSENTHAL: Yes, Bob.

MR. STECHERT: You asked whether the FCC could lift that restriction, it's not within the FCC's jurisdiction to decide whether the Local Exchange Companies provide intraLATA service...

SENATOR ROSENTHAL: The judge.

MR. STECHERT: Yes, that's right. It's within the jurisdiction of the Federal District Court that oversees the anti-trust consent decree that created those restrictions in the first place. So, just for purposes of the record, I'd like to make that clear.

SENATOR ROSENTHAL: Fine, thank you. O.K. Ann Pongracz, Director of Internal Affairs, US Sprint.

MS. ANN PONGRACZ: Thank you, Mr. ...excuse me. Thank you, Mr. Chairman. Today, I'd like to discuss some of US Sprint's concerns that have arisen from Phase I, and Phase...the approach to Phase II that the Commission is taking here. And my comments are also prepared in writing and I'll submit them for the record.

Regarding Phase I, we have two major concerns. The first is the approach that was taken to the settlement procedures. Now, US Sprint is not opposed to the use of settlement procedures per se, but there are some serious problems with the way the settlement was used in this case, that I think deserve attention, and needs to be remedied if the settlement approach is going to be taken in the future.

First of all, more attention needs to be spent on insuring the full participation of all parties. Assemblywoman Moore raised, several times today, her concern about the attendance by invitation only. While I don't think that it got to be that bad, the problems were not that severe. But at the same time, it was very difficult for most of the parties, including Sprint, to figure out as we were going through this process, what was going on, what the issues were, what our options were; you know, basically, who's on first and who's up at bat next. It's very difficult to figure out and that raises obvious due process concerns when you come to evaluating whether people have a full opportunity to be heard.

Secondly, in any kind of a settlement process an approach needs to be developed which it gives the Commission enough evidence to base its decision on. We're concerned that the approach that was taken in the Phase I settlement, where there was no written record, and where the parties basically sat in a room for three weeks, and negotiated among themselves, and then negotiated a settlement, which then sat with the Commission for five months, there was no clear record that the parties could refer to, or that the Commission could refer to, in either developing a decision or, for example, if someone would wish to appeal that decision, it's unclear how they would make an appeal work.

SENATOR ROSENTHAL: Did you raise that question?

MS. PONGRACZ: Actually as we were going through the process, it didn't occur to us. It's only at this point, when...we had assumed that the Commission was going to accept the settlement, or reject it in its entirety, and that we were working in a very informal process and that that wasn't needed. What we found out, though, was that the Commission did not accept it or reject it in its entirety. Instead what happened was that the Commission held the decision, proposed settlement for five months, and then issued a proposed decision which accepted some parts of the proposed settle-

ment and rejected others. And then give parties only a very short amount of time to comment on whether the settlement in its amended form was appropriate. And...that was the juncture in which we became very concerned, and at that point we did express our concerns that, basically, time out here--this wasn't the way we thought this was working. And we don't feel that, parties as a whole, had a fair opportunity to be heard throughout. And in the future, it's our recommendation that, if the Commission will utilize the settlement approach, that the requirement be instated that if they accepted or rejected it in its entirety, if the Commission feels it needs to make changes, fine, reopen the case, reopen the negotiations and everything's up for grabs again. We can't be presented with a modified fait accompli.

SENATOR ROSENTHAL: Let me break in at this point. This is something that I was not aware of, PUC staff. Can you comment on that--Carl Danner?

MR. DANNER: Yes, I can, Senator. The PUC was faced with a difficult decision in the Phase I settlement. There were aspects of it that were clearly illegal in the opinion of our attorneys. Commissioner Wilk had expressed that this morning. And while one couldn't be certain of how this would weigh, I think it was fair to characterize some of these infirmities as favoring one side or favoring the other. For example, the inter-exchange carriers primary concern, as I understand it, was that the provision of the settlement provided that they would have automatic intraLATA high speed private line authority was left out of the settlement because the Commission's attorneys found that they needed to make some sort of an application for that authority. How the Commission expects that these applications will be processed on sort of a routine basis, but that was their concern. Some of the local exchange companies had a similar concern with the provision of the settlement that provided for privacy, or secrecy, regarding special contracts. The Public Utilities Code is clear that that's not permitted. So, what the Commission did, was to modify the settlement and offer it back to the parties for their acceptance or rejection. So the Commission did not unilaterally modify the settlement; rather the Commission proposed an alternative settlement modified in as few ways as we thought would make it legally sustainable, and then offer it to the parties. There was no intent to change any of the policy conclusions of the settlement, and I don't think there were any policy changes.

SENATOR ROSENTHAL: Well, obviously, there were. I'm listening to somebody...and we heard also earlier this morning that there was non-acceptance. Is it usual that there's not written record of a proceeding before the PUC?

MR. DANNER: In this case, we took...

SENATOR ROSENTHAL: Why is this case different?

MS. PONGRACZ: Carl, could I take a shot at that?

MR. DANNER: Please.

MS. PONGRACZ: I think one thing you need to understand, Senator, is that, in a lot of ways, a lot of these problems are the product of the fact that this is breaking new ground here. This is a new approach that the Commission is taking.

SENATOR ROSENTHAL: More reasons for a record.

MS. PONGRACZ: Well, we would think so. Yea.

MR. DANNER: There was a record, Senator, in the form of briefs and comments filed by the parties, as well as the settlement document itself. The several months that Ms. Pongracz referred to, between the time that the settlement was presented to the Commission and the time the Commission acted upon it, included a couple of rounds of comments and responses to written requests by the Administrative Law Judge to fill in the details, so there's quite a full record on it...on the settlement. We didn't have the formal evidentiary hearings, where each party stood up and presented its position, because the settlement took the place of that.

SENATOR ROSENTHAL: What I've been hearing is that there was a decision made, after some input, which was changed and different than what everybody had agreed to.

MR. DANNER: The Commission issued two decisions to consider the settlement. The first decision said that we cannot accept the settlement as it has been written because of the legal infirmities that I've referred to. The Commission then said...gave the parties, I think it was 15 days or two weeks or something like that, to consider whether they could accept the settlement as it had been constituted without the legal problems.

SENATOR ROSENTHAL: Well, but then they had the gun against their head. What were they going to do at that point?

MR. DANNER: Well...

MS. PONGRACZ: Senator, you've really hit the situation on the head.

SENATOR ROSENTHAL: That's, that's...really what I'm hearing. That's unconscionable in terms of a proceeding, in my opinion.

MR. DANNER: Well, Senator, if the parties had rejected the settlement as revised, we would have gone into hearings.

SENATOR ROSENTHAL: It was difficult for them to reject it at that point.

MS. PONGRACZ: And we did go through that thought process, Senator, of trying to decide whether we were so disturbed by the procedure that had been followed, that we should no longer participate in the deal. We tend to feel that either we've got a deal or we don't have a deal. And our agreement to sign on to the settlement was based upon our understanding of what the terms of entry into the market were going to be, and what the new special access rates were going to look like. And once you change one of those elements, you change the incentive that we had for signing. So, we were really caught between a rock and a hard place.

MR. DANNER: If I might offer, Senator, the Commission was somewhat similarly situated.

SENATOR ROSENTHAL: Why were they in such a rush? One of my concerns all along has been that the Commission has been hell-bent on doing something in a hurry. We've got a system now in existence for fifty years and we want to change it now in one year. That's, that's what it started out to be. And it seems to me there's something wrong with the Commission's approach which says they have to do that today.

MR. DANNER: If I might, Senator, I think that the decision that the Commission was faced with, when it issued that first decision I referred to, was whether to reject the settlement in its entirety and throw out all the work the parties had done and go into full hearings, or in the alternative identify what the legal infirmities were and specify what it would take to correct those, so that the appli...so that the decision could stand...withstand legal review, and offer it back to the parties. The Commission chose the latter of the course, and gave the parties a chance to salvage the work they had done.

SENATOR ROSENTHAL: And so the parties made a mistake by feeling that they had a gun to their head and accepting your changes on the basis of your attorneys, and really were not happy with the decision that was being made.

MR. DANNER: I believe all but one or two of the parties endorsed the settlement as revised.

SENATOR ROSENTHAL: That's...well, what we've heard now is at least two cases of where they weren't. So tell me who...who approved it, if two of them said no?

MS. PONGRACZ: Senator, for example, Sprint signed that. Because we thought we...oh...

SENATOR ROSENTHAL: Oh, no, I understand that you did, but it was not a choice.

MS. PONGRACZ: That's correct.

SENATOR ROSENTHAL: Cable was unhappy; Bay Area Teleport was unhappy; they're unhappy. I don't know who else was unhappy.

MR. DANNER: I believe that Cable...

SENATOR ROSENTHAL: MCI was unhappy, but was placed in a position of a gun against their head. Is that what the Commission's all about? Is that what we're talking about?

MR. DANNER: It was their agreement, Senator. I...frankly, if we had known this would have happened, we would never had permitted the settlement discussions to go forward. We would have started the hearings at the appointed time.

SENATOR ROSENTHAL: It seems to me that that set the tone for the hearings. That that set the tone for the future of number two and number three, and there's something wrong if you start off with a procedure which forces people to accept something that they think is in their best interest, they shouldn't be accepting. And there's something wrong with the Commission's approach.

MR. DANNER: If I might offer, Senator, I think the parties were more in control of the approach, then was the Commission. When we were all set to go to hearing and the settlement negotiations broke out, led by the Division of Ratepayer Advocates, and they were in process for several weeks, we kept postponing the hearings to accommodate the settlement process. I'd be happy to supply you with copies of all the questions and inquiries the Commission sent to the parties, and the responses they got, to try to clarify this settlement and to show what it really meant. The judicial...

SENATOR ROSENTHAL: Do you think the Commission is now sensitized to

the position of those who had problems but were afraid to express them because they didn't know what the Commission was going to do?

MR. DANNER: I think it was rather clear what the Commission was going to do. Because one...at least one of the Administrative Law Judges rulings that were sent out several months prior to the Commission's decision, detailed these legal infirmities in some length. So we were, frankly, quite surprised that any of the parties could have been taken aback or not have expected the Commission's legal conclusions, because they were laid right out there for the parties to see.

SENATOR ROSENTHAL: I think the Legislature should take a look at the concept of those law judges that are related to the PUC. I really think we ought to do that. I think those law judges are in your back pocket, in my opinion, and are not taken out of the pool of law judges that all other agencies and commissions need to deal with. And I think I'm going to take a look at that. And we ought to have an audit of what's happening in that particular respect. Those law judges are not independent. They do not... they're not able to make a decision on their own, that makes the Commission unhappy. And so, it seems to me, we ought to take a look at what's happening in that particular area, and that's another subject. But I just want you to carry back to the Commission my unhappiness with what's happening, not just in this case, but other kinds of cases that I'm hearing about, in which law judges are making arbitrary decisions based upon what the Commissioners want, not what the constituents or the consumers want, that are supposed to be answered by those particular law judges. And I don't know of any other commission that has that particular setup, and I think we ought to take a look at it for the future.

MR. DANNER: Thank you, Senator. I will convey that concern back to the Commission.

SENATOR ROSENTHAL: Thank you. Okay. Ann, I'm sorry. I broke in on you because what started this morning, gave me some unhappiness, and finally hearing the Commissioner say today that there...now there's going to be some more time. There wasn't going to be any more time up until the time that we had a hearing, maybe, or set a hearing. And that's beginning to bug the hell out of me and I must tell you, and excuse my language, that nothing appears to happen to change a thing, until the Legislature says "Hey, hold

up, let's take a look at what's happening here."

I'm sorry to have interrupted you and I'm sorry...I don't mean to attack you. Just carry the message back to the Commission. Yes.

MS. PONGRACZ: O.K. thank you, Senator. I'll move on to some of our concerns about Phase II. We join in what AT&T and MCI have said as far as being very interested in supporting the Commission's effort to evaluate whether the form of regulation that's been used in the past continues to be appropriate. But what's going to be decided in Phase II is much more important for California consumers than what was discussed in Phase I. This is a major proceeding. We are very pleased to hear from Commissioner Wilk that we'll be having some more time to look at the issues. We're concerned that the Commission take the full amount of time that they need to really come to a good conclusion. As you heard from Sprint before, our major concern about the new regulatory flexibility proposals that are before the Commission is what's going to happen to carrier access. Like MCI, Sprint spends 50¢ of every dollar of our total operating cost on access charges that we pay to the local exchange companies. That means, only less than 50% of every dollar of our revenues is available to us, to operate our company, do our advertising, operate our network; all of our total expenses have to be done on less than 50% of every dollar we take in. Access charges continue to be priced far above the cost of providing access to us. And the local companies continue to have a monopoly in the access area and they will have that for the foreseeable future. So, our main concerns about regulatory flexibility are, what will the impact be on access? And we have two major concerns about that. First of all, what approach...what mechanism will be in place to insure that we are not overpaying access charges; that there is no requirement that we continue to pay more than the cost of access and access charges; and perhaps even that we get some opportunity to have those costs reduced. Now in recent years we've seen SPF to SLU, which has been helpful; we've seen attrition filings, financial and operational attrition filings; those filings basically, they're like a reversed surcharge...reverse...the gas surcharge that was big in the 70's. This Commission has attrition filings to flow through cost reductions. What the local companies are requesting here is a freedom to have from those types of filings in the future. If Commissioner Wilk today stated, this Commission will have signed on almost a billion dollars worth of rate reductions this year, through the attrition mechanisms,

and some other forms of rate cases. If the proposals that PacBell has made are accepted, there will be no way to get comparable rate reductions in 1989, 1990-91. We're very concerned because the proposals that have been put on the table, the proposals to eliminate touch-tone, to increase the "zum" coverage areas, to freeze residential rates, insure that there's going to be a pot of money that's going to have to be recovered from someplace. We're concerned that it may be carrier access. And if we do not have rate cases, attrition filings, or any other procedural mechanism for seeking rate reductions, we're very concerned that access may be left holding the bag. Now that's, obviously, bad for inter-exchange carriers. We also think that it's very bad public policy. Ultimately, it's just not sustainable to have the interLATA customer base paying a disproportionately high share of the cost of operating the network.

In conclusion, we recognize that the Commission needs to maintain strong regulatory oversight. Certain people have suggested to you that nobody's talking about deregulation. Well, I think you need to think through very carefully whether that's true. Deregulation will not work, unless the regulators have the facts and figures in front of them, that they need to be able to tell where the dollars are going. Under many of the regulatory flexibility plans there will be a window, there will be a wall, between them and that information. There will be no requirement that that information be developed and produced, and there will be no opportunity for either the staff or other parties to take a look at information that could enable the Commission to determine what's going on, whether cross subsidies are occurring, whether rates are moving towards cost as they should be. So, we hope that the Legislature will take very seriously the issue of what regulation needs to be, to get us into the next decade.

SENATOR ROSENTHAL: Thank you very much. Mr. Frockt, CalTel. That's ...communication...

MR. RICHARD FROCKT: California Association of Long Distance Telephone Companies, Senator.

SENATOR ROSENTHAL: O.K.

MR. FROCKT: Thank you for the opportunity to be here and speak on behalf of the smaller...

SENATOR ROSENTHAL: Will you pull the mike a little closer to you.

MR. FROCKT: ...Speak on behalf of some of the smaller long distance companies.

SENATOR ROSENTHAL: That other mike may be a little bit better. Do you want...?

MR. FROCKT: It's just a matter of us taking all the work out...
(chuckles)

MR. FROCKT: Our membership in CalTel ranges all the way from companies the size of MCI and Sprint to small California companies such as ours, and the one I represent individually called TMC Communications. We find ourselves in a very strange position, in this proceeding, that we have to agree because of the way the future reads with everyone else sitting at the table. And, but also agree that competition has made all our businesses better over the last four or five years. CalTel supports the introduction of competition in intraLATA services, including both private line and switch services. We believe, though, that PacBell as the major dominate intraLATA carrier, even in an open intraLATA market, needs to be controlled to a certain extent. Accordingly, with the inter...with the advent of intraLATA competition, we need to accompany that with the adoption of some sort of dominate, non-dominate carrier provision services, as reflected with AT&T, and they were regulated during their deregulation process. Eventually PacBell should and will be afforded some rate flexibility with respect to intraLATA services for which it no longer possesses a monopoly. Such rate flexibility should not, however, be permitted. I think this is important to us, until the Commission and the affected parties have some opportunity to monitor what has occurred over the deregulation process. The former monopoly, such as Pacific Bell, is still a monopoly, until effective competition is granted. I think that's the key words. The historical difficulty in trying to determine rates and rate structure as it relates to access charges, intraLATA toll rates, will become more difficult with the suggestions that Pacific Bell has put before the PUC. We believe competition should come, and we also believe that the rates that Pacific will charge to the customer base should be priced to cover the intraLATA access charges, while they're originating and terminating that. Accordingly, access charges should generate significant contribution to non-traffic sensitive calls recovery, at least through the SPF and SLU transition of 1992. These factors combined with the

projected growth in toll minutes should alleviate any significant pressure to raise the plain old telephone service. While Pacific Bell and other local exchange carriers should not be unduly burdened in a new competitive environment, care should also be taken to insure that the same local exchange carriers cannot through cross subsidy, to properly compete with the new marketplace.

Mr. Chairman, we believe that competition should occur. We also believe that we should walk very gingerly through this first few years and not be rushed in determining that competition's good, just because it's called competition.

SENATOR ROSENTHAL: So it's basically here a universal opinion from the long distance companies. Everybody seems to be saying the same thing, basically.

MR. FROCKT: I think from different parts of the...

SENATOR ROSENTHAL: Well...

MR. FROCKT: ...of the agenda, but I think at one time we all believed one thing, that there should be competition, at least from CalTel's standpoint.

SENATOR ROSENTHAL: Yes.

MR. FROCKT: But since government granted monopoly, at some time in the past, we should be very careful in unleashing monopoly carriers at this point.

SENATOR ROSENTHAL: Alright. I think we've heard today the concerns of many parties, who not only fear less service from their telephone company for a more competitive advantage, but also fear that possibly their ideas and proposals will not be heard by this Commission, PUC. I have no doubt that we'll be moving toward greater competition; I think that's coming, but whatever direction we move, we must make sure we have a secure way to have control over the quality of service and ways to prevent cross subsidization, which fosters unfair competition. If the Commission continues to be insensitive to parties and their need to give testimony, with arbitrary deadlines, then I must think very hard about asking other forces, like our Senate Office of Research and others, to review for the Legislature and our subscribers the benefits and drawbacks of all the proposals from witnesses who wish to be heard. I think we've had a good full hearing. I want everyone here to know that this Committee will continue to oversee this important issue. And

that concludes the formal part of our session.

We now have an open microphone for those who have signed up, who would like to make some comment. Mili Falk.

I want to thank you for participating in this presentation this afternoon, and for being here this morning. Is Mili Falk here?

MS. MILI FALK: Here I am.

SENATOR ROSENTHAL: Oh, fine. O.K. Mili, you have a couple of minutes to tell us what you think ought to happen.

MS. FALK: I represent two big senior organizations, one Beverly Wood Senior and the National Council of Senior Citizens. I'm also having some people from the Wilshire Christian Church here today. We feel that this deregulation is a horrendous, outrageous charge for us as senior citizens. I realize now, after speaking to Mr. Jamieson, that there will be a freeze and he's not sure whether it will be four years or less or more. Years ago our phones were a luxury; today it's a definite necessity. There are too many seniors who are only able to live on small fixed incomes; homebound people need their phones; also the people that are handicapped, they need to be in touch with the outside world. And there are many who not only need their phones just to speak to people, socially or otherwise, but they need it for business, like selling magazines or newspapers or the like. Two years ago I was here asking PacBell not to raise our rates and they listened to me, and I only hope that they are going to listen to me today.

SENATOR ROSENTHAL: You're responsible for keeping the rates down, right?

MS. FALK: Well, we're trying very hard.

SENATOR ROSENTHAL: Congratulations to you. Thank you.

MS. FALK: We're trying very hard.

SENATOR ROSENTHAL: I'm not smiling, I'm not minimizing your efforts.

MS. FALK: You know...yea. During our earlier years all the seniors worked hard to enjoy what they called "Our golden years", so we could relax and do whatever we want. Well, that doesn't happen to be true now. It seems that we have to fight one cause after another and our work is just never done, at least mine isn't. As you know, a lot of seniors are living longer and many have to get into some sort of work to supplement their income. And it's just too hard to have to continue high phone rates because it's difficult to make ends meet. Ever since AT&T deregulated, PacBell and GTE lost a sub-

stantial amount of revenue. And now they want us to pay for it. At least, that's the way we feel, they want us to pay for their losses. For every small or large service that we need, and ask PacBell...I'm not too sure of GTE because I only work with PacBell...they ask exorbitant charges which we cannot afford. And in order for us to have to pay these high rates for the service, we have to deny ourself some of the small necessities that are important to our health. Remember, that the seniors are the backbone of our country, right or wrong, and their power is getting stronger and stronger. I wish to show you about senior power. I just read the other day that there are approximately 65 million people from the age of 50 and over. And by the year of 2000 they expect to have 76 million people. So, we are getting powerful, day after day, and we need to have things done so we can relax and not have to worry every minute about a charge being raised for the different utilities, whether it's phone, gas or electric. And I just mentioned to Mr. Jamieson, which he did not know, that a couple of years ago in talking to someone from PacBell, they told me that in order to make a long distance call, you'd have to have one of the touch-tone phones. No more dial tone. So I ran out and bought a touch-tone phone. Never used it. Because that never went through. He didn't seem to remember that. All I can say is, I brought these people here to stick up for us, and we need to have things done so we can live a little better life. Thank you, Senator Rosenthal.

SENATOR ROSENTHAL: Thank you for your presentation.

MS. FALK: I'm glad you're my Senator.

SENATOR ROSENTHAL: We have one other person, Virginia Jarrow, from the Consumers Coalition of California. Welcome.

MS. VIRGINIA JARROW: Good afternoon. I would have gone into the formal hearings, but I didn't have time...Oh, I would have entered the formal hearings, but I didn't have time to respond.

SENATOR ROSENTHAL: Sorry.

MS. JARROW: I would like to start out by reading a brief statement.

SENATOR ROSENTHAL: I don't want you to read this three page statement. Tell me...

MS. JARROW: O.K.

SENATOR ROSENTHAL: Tell me what you think, and we'll listen.

MS. JARROW: Alright, you don't want me to read this, why? Why?

SENATOR ROSENTHAL: Summarize.

MS. JARROW: Alright, I'll summarize it.

SENATOR ROSENTHAL: Look, you can pick out things from it, you know.

MS. JARROW: Alright, I'll be glad to. Fine.

Consumers Coalition is speaking for the consumer intervenors, familiar with the areas in which consumers reside. And we're talking for the people of Southern California who do not have representation. We heard here today, two San Francisco-based intervenors, who were not familiar with what was going on in this area at all. They did not know what the problems were, these people that are sitting behind me, because they simply were not using the system. The other thing Senator, that I...if we can put this in the record I would like to...

SENATOR ROSENTHAL: Very happy to.

MS. JARROW: ...introduce a study that was done by General Telephone, GTEC, and Consumers Coalition of California which answers something you were talking about this morning, the monitoring of service quality. I think it's a first that has been done...

SENATOR ROSENTHAL: Thank you.

MS. JARROW: ...in this system. And we found so many things; now, this was very independent. GTE made no effort to influence what we put into the record. We really paid no attention to their dogma, the way that they stated things were working, but examined the system and went through the system. We went through it with a data processing expert. And this man was able to find glitches in the system that I think were interesting. We found that as many as...by the way this is in the hearings, and it's the third part of the GTEC decision that they're going to be looking at the service, that people were being charged for one minute calls. And that they were being charged as many times as two to three times within one minute, so that the start-up charges for one minute calls could be three minutes for one actual minute of performance. We also discovered that calls were being registered as completed, that were not completed. Sometimes, it was due to the fact that systems, electronic switching systems, were not interacting properly. We looked into the billing practices. And oh, going back to the switching systems, there were also problems in the pathways. Sometimes they were put on a pathway that took them on a long way around, and people were

charged for this. A lot of times the equipment does not release when it is supposed to release. And you can talk fifteen minutes and be charged for 20-25 minutes. Now, what we've run into are business people calling us. A lot of business people who are very, very disgruntled with this. They are not going to sit down and do what we did, which was to monitor the system for 14 full months. What they are going to do is just move out of the area. And this is what we're listening to: they don't want corrections; they don't want anything; they want that bottom line on their bill. It's costing them too much to operate in the State of California or within these telephone systems.

O.K. The other thing we found was in the billing practices. That, although we are told that there are checks in the billing practices, there are not; there are engineering checks. There's no check on the data that is going through there. And if the engineering goes off for say five seconds-ten seconds and a run is going through a billing, whatever errors are there are there permanently until it is put back on line again. So, these were some of the things that we found that really needed to be looked into. We feel that there are hundreds of millions of dollars in hidden costs that may not be due the telephone companies, that they are collecting for things to which they are not entitled, and this has to do with engineering, it has to do with data processing, before it ever gets to the billing. The billing part of the operation was O.K., but this interim part is all wrong. MCI has just had a settlement -- we heard about that, in Illinois -- and I think that it's time that both Pacific Bell and General Tel have a settlement. The people deserve to have this money back. And I think that's basically it, and the rest of it is contained in the study.

SENATOR ROSENTHAL: Right. Have you had an opportunity to be involved in the hearings that are going on?

MS. JARROW: Yes, we were in the evidentiary hearings. And the study that you have there was part of the evidence. And that was the hearings that were concluded in 1987, and two parts of the decision have come down for GTEC, the third part has not come down. But I believe it's the first time there's ever been an audit by a consumer organization.

SENATOR ROSENTHAL: I'm talking about the present regulatory process which is now going on, in terms of...

MS. JARROW: No, we're having difficulty. Because we can not make all those trips up to San Francisco. Just like the San Francisco intervenors can't make all those trips down here.

SENATOR ROSENTHAL: There is a public advisors' office, which I established here in Los Angeles. Are you aware of that?

MS. JARROW: We're familiar. We've worked with them. We get referrals to...from the intervenors thing, which I believe you set up, which is really a marvelous thing. And we're getting a very good picture of what's happening. And what we've been doing, is a lot of pro bono. We've been helping individuals like these ladies and gentlemen behind us, who do not know how to get through simple problems and we refer them, and just give them what assistance is necessary. And Senator, I think this is a marvelous thing. I think California is way ahead in doing this. And there's a lot of things that you have innovated that I really respect.

SENATOR ROSENTHAL: Well, then there should be less of a problem in getting input into the system since we've established this, and you ought to be in touch with them daily if necessary, or whenever your organization...

MS. JARROW: We do, but when the hearings are not down here, we can't do anything about it. We're involved in some SCE evidentiary hearings, too. And the very problem that you've talked about of settlements is exactly what is going on in that, too. Settlements made ahead of time that are absolutely ridiculous. And we could give you a look at that, if you're interested.

SENATOR ROSENTHAL: Thank you very much.

MS. JARROW: You're welcome.

SENATOR ROSENTHAL: We appreciate your input.

Is there anybody that feels impelled to make a one minute statement before we adjourn?

Yes, ma'am.

MS. CLEIA SCHIFF: I don't know whether I understand this issue properly. But I understand that they only want to give you six minutes to speak on the telephone. I am hard of hearing. And when I get on the phone I have to understand who's talking to me. I cannot do it in six minutes. You call up for information, they tell you "hold the wire", they let you on there ten minutes, fifteen minutes, I've already waited more than that. You cannot get the message. What are we going to do?

SENATOR ROSENTHAL: Would you talk to Ms. Jarrow over there? Any one else?

MS. SCHIFF: Do you want me to speak?

SENATOR ROSENTHAL: No.

MS. SCHIFF: Oh.

SENATOR ROSENTHAL: I want you to speak to...

MS. SCHIFF: To who?

SENATOR ROSENTHAL: ...the young lady who just...Virginia...

MS. SCHIFF: You mean privately?

SENATOR ROSENTHAL: ...Virginia Jarrow. Yes.

MS. SCHIFF: Oh, O.K. Right now?

SENATOR ROSENTHAL: She can solve your problem.

MS. SCHIFF: Or afterward?

SENATOR ROSENTHAL: Whenever, whenever.

MS. SCHIFF: I'll wait until after everything is over. Thank you.

SENATOR ROSENTHAL: Yes, sir?

MR. EDWIN MARCUS: I would only like to ask...

SENATOR ROSENTHAL: Would you come to the...forward? We're taping this, and I just want it on the record. This will be the final one, and then we'll be through for the day.

MR. MARCUS: I would like to ask you, Senator, I'm a man of 84 years old...

SENATOR ROSENTHAL: You look very good.

MR. MARCUS: ...and before I close my eyes, do you think there's going to be a little relief for us senior citizens? The way it looks to me today, it looks dim. I hope more Senators like you listen to these problems and do something about them. Thank you.

SENATOR ROSENTHAL: I am trying. I'm only 70. When I get to your age, I will have solved the problems. (chuckles)

Thank you very much for coming. It was a good session. Adjourned.

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MICHAEL E. SHAPIRO
SENIOR CONSULTANT

PATRICIA J. STEARNS
COMMITTEE SECRETARY

ROOM 2035, STATE CAPITOL
SACRAMENTO, CA 95834
TELEPHONE: 445-9764



MEMORANDUM

TO: MEMBERS, SENATE ENERGY & PUBLIC UTILITIES COMMITTEE

FOR: OCTOBER 25, 1988 INTERIM HEARING

FROM: COMMITTEE STAFF

SUBJECT: MOVING TOWARD GREATER COMPETITION--
PENDING REGULATORY CHANGES OF OUR LOCAL TELEPHONE NETWORK

THIS HEARING:

WILL FOCUS ON THE PUBLIC UTILITIES COMMISSION'S (PUC) MAJOR ON-GOING INVESTIGATION WHICH SEEKS AN ALTERNATIVE APPROACH TO THE PRESENT REGULATORY SYSTEM FOR LOCAL TELEPHONE SERVICE, AND THE POSSIBLE RESULTING IMPACT TO TELEPHONE SUBSCRIBERS AND COMPETITORS. THE HEARING WILL FOCUS ON THE STRUCTURE, SPEED, AND DIRECTION OF THE PUC INVESTIGATION, AND HOW THE SIGNIFICANT PACIFIC BELL PROPOSAL FOR GREATER LOCAL COMPETITION, AND OTHER PROPOSALS, MAY BE IMPACTING THE INVESTIGATION--AND ULTIMATELY, THE TELEPHONE RATEPAYER.

SECTION I. BACKGROUND: RECENT REGULATORY CHANGES;
LEGISLATIVE RESPONSES

SECTION II. PUC'S PROCEEDING TO CHANGE REGULATORY APPROACH

SECTION III. UTILITY PROPOSALS FOR GREATER COMPETITION

SECTION I. BACKGROUND: RECENT REGULATORY CHANGES:
LEGISLATIVE RESPONSES

A. LEGISLATIVE OVERSIGHT AND REVIEW

The divestiture of AT&T and the movement of the Commission to establish a new regulatory regime for local telephone service has raised a host of issues which have been brought to the attention of the Legislature. These have included:

- ° how to determine what constitutes "basic telephone service", and therefore what telephone service can or cannot be given greater regulatory and pricing freedoms;
- ° how to determine what constitutes a "competitive service", and therefore what services the telephone utility may price as it wishes, in competition with non-utility providers;
- ° if the system of "general rate cases" should be changed, and if so, how a changed system can best respond to the nature and dynamics of today's technology-motivated telecommunications industry;
- ° determining how quality of service can be protected for telephone subscribers when utilities have greater regulatory freedoms;
- ° assuring that the PUC processes involved in changing the regulation of telephone utilities follows due process in a rational time frame, remains open to all witnesses and proposals, and is not unduly influenced by the impacted utilities.

The Legislature has also had to confront and oversee a variety of interests and parties, all with different perceptions about which direction the regulation of the telecommunication industry should go. These include:

Local Telephone companies: who are working hard to build support for greater regulatory freedoms with "social contract" and "rate flexibility" proposals. Both Pac Bell and GTE California have submitted plans to the PUC to basically keep residential rates stable, while using flexible pricing for other services and sharing in the profits through incentive programs. Pac Bell, in an attempt to capture the lucrative toll markets, has further announced a proposal to open up competition in the intraLATA markets in the state.

Consumers: who have raised concern about changing the way telephone companies' are regulated, have raised suspicions about the speed of the PUC proceeding which they say leans toward the telephone utilities' wishes to deregulate at the expense of ratepayers and in favor of shareholders.

Public Utilities Commission: which initiated an ambitious agenda focused on changing the way telephones are regulated in the state. Some commissioners have been outspoken about the need to deregulate the industry quickly.

Competitors: who are fearful of granting Bell Operating Companies too many freedoms when they are competing in similar services. They testify that ratepayers have been used to unfairly finance a giant competitor's wishes to compete in an "unlevel playing field."

Long Distance Companies: who are working with the PUC and the Federal Communications Commission to establish "rate flexibility" plans of their own, but are suspicious of Pacific Bell's attempt to open up the local LATAs. They contend that Pac Bell's willingness to allow local competition (where it is doubtful that long distance providers might enter) may be to shore up support to next open up the long distance markets (where Pac Bell could be an aggressive competitor).

In each of the past two years this committee has held an interim hearing concerning the issues of moving toward greater competition in telephone markets. The first was held soon after divestiture to determine the general regulatory direction of the Commission. Last year's hearing reviewed the PUC's move to allow AT&T a flexible rate plan, and the commission's newly-announced investigation to change the regulation of local telephone networks. This year's interim comes when the PUC is beyond the midpoint of its investigation, is revealing some possible directions of regulatory change, and is scheduled to make important decisions early next year.

Recent legislative proposals addressing some of these concerns have included:

SB 1433 (Rosenthal), Chapter 1079 of 1985, which required the PUC to evaluate the deregulatory efforts of other states, and study the feasibility of establishing an open-competition pilot project in one of the state's LATAs to allow the PUC to monitor changes.

SB 757 (Rosenthal), Chapter 433 of 1987 which required the PUC to report to the Legislature on the rate of return levels used for the large utilities, compared with ROR for other state industries and out-of-state utilities.

SB 680 (Rosenthal), vetoed Sept.'88 by the Governor, asked the PUC to present the Legislature with a report on its recommended changes to the local telephone network resulting from the present investigation, and would have required that the implementation of the Commission's decisions on each phase of this investigation be delayed for 60 days to allow adequate review.

AB 4174 (Moore), Chapter 673 of 1988 requires the PUC to investigate the possibility of including tone-dialing services within its definition of "basic service".

SB 1844 (Russell), Chapter 1261 of 1988 deregulates telephone corporation billing for information-access services (i.e. "976") where the utility determines the information contains "harmful matter".

SB 1800 (Rosenthal), failed in E & PU Committee, would have required the PUC to report to the Legislature on the standards it uses to determine when a telephone service has become competitive in the state.

B. DIVESTITURE & RATEMAKING

The 1984 divestiture of AT&T resulted in a new regional holding company being established in California to operate in the local Bell service area. Pacific Bell is the regulated utility side of the Pacific Telesis holding company. The second largest telephone company in the state is GTE California (GTEC) serving approximately 20 percent of the state's telephone customers. There are also more than twenty smaller local telephone companies serving primarily less populated areas. Ten local service areas (LATAs) were created in California after the divestiture, with Pacific Bell and the other locals responsible for service within each LATA (intraLATA). The competing long distance companies are responsible for telephone service between each LATA (interLATA).

The divestiture has not altered the responsibility of the PUC to regulate the rates and services of telephone utilities, and basically the Commission has continued its "Rate of Return" (ROR) type of rate determinations. Utility rates are designed to cover the telephone company's current expenses (labor, fuel, supplies), depreciation, taxes and return on the invested capital. The total cost figure is called the utility's "revenue requirement". The process of determining how rates will be recovered is called "rate design".

There are currently two types of rate cases: general rate cases and special adjustments. General rate cases are held once every three years for each utility and its revenue requirement is determined on projections of expenses needed to meet expected sales in a "test year". Test year estimates are used in subsequent years until the next general rate case. "Adjustment mechanisms" allow regulators and utilities to deal with expense fluctuations which occur between general rate cases.

Two other important rate proceedings are "attrition adjustments", which reflect cost-of-living increases or decreases outside utility control, and "new construction", which tests the reasonableness of such costs and adjusts rates accordingly.

This rate of return regulation, basically allows companies to pass along almost all of their costs to customers and guarantees earning a profit on their investment. While most consumer organizations involved with utility issues have been critical of specific aspects of ROR, they have defended the system against drastic change because they say real costs for phone service since the federal Communications Act (1934) have declined by 60 percent under this type of rate regulation. They also point out that the utilities under ROR regulation have grown tremendously and accumulated massive financial and physical capital, with many diversifying rapidly into lucrative unregulated ventures. ROR, they say, has proven to be flexible because regulators have been able to impose penalties where they have felt utilities have either not served adequately or charged

too much. At this time, supporters of ROR believe monopolies should continue to be regulated in this manner, and that the system may only need "fine tuning" to correct deficiencies.

Critics of ROR say the system is too old to meet with the changing nature of the telecommunications environment. They say that by continuing to regulate utility services that are competitive, ROR is preventing price competition among these services, causing the utility to make unnecessary investments, encouraging waste, and depleting incentive.

C. PUC REGULATORY MOVEMENT

Shortly after the 1984 divestiture, the PUC adopted a policy of maintaining a clear distinction between local monopoly service and long distance. But, where some other states, less complex than California, have moved quickly to "deregulate" certain telephone services, this state, until recently, has maintained a more cautious attitude with respect to charting a fast-tracked competitive course.

Coinciding with a dramatic personnel turnover at the Commission due to gubernatorial appointments of new commissioners, the PUC has undertaken what some consider to be a "fast track" approach to deregulating the telephone utilities' ratemaking procedures. Telephone utilities, themselves, believe that restructuring regulatory oversight is long overdue.

Sparked by utility "rate flexibility" proposals since 1986 (see SECTION III below) the PUC initiated an en banc hearing on telephone regulation in September of 1987. At the en banc hearing, the Commission announced its plan to hold a major investigation (OII) to consider alternative approaches to regulation of local telephone service:

"I (Commissioner Wilk) propose that we conduct a full reexamination of every major aspect of local exchange regulation. This investigation...would start in January and proceed expeditiously. We aim to have major elements of this process complete within a year, so that corresponding regulatory changes could be implemented as of January 1, 1989."

Since that announcement the PUC has moved quickly to address three major areas of investigation. In September, the PUC completed its Phase I investigation by approving a modified judgment for those services it says the local telephone companies must compete in order to prevent large customers from bypassing. Also last month the Division of Ratepayer Advocates (DRA) completed its "Report on Alternative Regulatory Frameworks for Local Exchange Carriers Phase II", which recommends greater deregulation, rate flexibility and utility incentive programs to share revenue increases. (see SECTION II below)

SECTION II. PUC's PROCEEDING TO CHANGE REGULATORY APPROACH

In July 1987, the National Telecommunication and Information Administration (NTIA), within the Department of Commerce, issued the NTIA Regulatory Alternatives Report, urging: that state and federal price, entry, and profit regulations be removed from "competitive" services, and that a new regulatory approach ("rate flexibility") be used with noncompetitive services. The PUC's en banc announcement set forth the basic recommendations of the NTIA study for Commission review and action in California.

Following the announcement for a September 1987 en banc hearing, the Public Staff Division, now the Division of Ratepayer Advocates (DRA), stated that the time was right to make long-term changes to the regulatory environment for telecommunications and that a PUC investigation was prudent. The Public Staff stated that the commission had already begun to move in a direction of "cost-based pricing" and that further changes should be met to address competitive challenges. Shortly thereafter, the PUC required local telephone companies to include in their billings an insert which announced that "TELEPHONE REGULATIONS MAY CHANGE IN 1988", which included the outline of Pacific Bell's proposal to the PUC for regulatory change.

In November 1987, the PUC formerly announced its investigation to "consider new regulatory alternatives for local telephone companies". The order would consist of three phases taking a year and a half:

- ° Phase I to address issues of pricing flexibility for services subject to competition.
- ° Phase II to consider alternative approaches for determining revenue requirements and basic rates.
- ° Phase III to evaluate the desirability of lifting the commission ban on intraLATA competition for message toll service and related services.

PHASE I. In August 1988, the PUC announced a proposed settlement on Phase I of the investigation with an agreement by most local and long distance companies. The parties basically agreed that local telephone companies should be allowed pricing flexibility in those competitive services (such as high speed private lines, centrex, call waiting, call forwarding, call hold etc.) as long as the flexibility would be used to reduce prices. Under the agreement, pursued by the PUC to prevent business customers from bypassing the local networks, the phone companies could vary the price of their services between a cap and a floor based on the costs of providing the service.

While most parties to the agreement, of this least controversial phase of the investigation, have raised no concern about the PUC process, a few parties were concerned with changes

made after the agreement was reached and before the final signing. Bay Area Teleport, for example, the only major intraLATA competitor of Pacific Bell, opposed the final agreement after changes were made and took exception with a PUC press release announcing that all major parties had agreed to the Phase I decision.

PHASE II. Last September, the DRA issued its report and recommendations for Phase II. Central to the DRA's report were themes espoused by telephone utility's which include, the need to simplify the telephone regulatory structure, the need to establish incentives for utilities to be more efficient, and the need to lift regulatory barriers on those services determined to be competitive. However, the DRA proposal differs significantly with Pacific Bell's in that it calls for indexing the rates of monopoly services, instead of a straight moratorium on residential ratemaking.

On October 7, 1988, the PUC held a pre-hearing conference for the parties interested in the issues to be discussed in Phase II. At the conference the DRA submitted a proposed hearing scheduled which would have started in late November, had a two-week Christmas holiday break, and concluded in mid-February. The schedule was rejected in order to meet a deadline to issue a final decision in Phase II during the first quarter of next year. The hearing will instead begin on November 7, and end on December 22.

Because of the major significance of what will be decided in this phase of the investigation (restructuring the entire way telephones are regulated and rates are determined), several parties have openly complained and have petitioned for a longer hearing time frame. This has included the DRA itself, T.U.R.N., and Bay Area Teleport, with others expected to follow.

PHASE III. The investigation involving the issues of competing for the business of toll traffic within a LATA will not begin until the completion of the Phase II investigation. However, the very dynamics of this review have changed since the PUC began its investigation, due to Pacific Bell's announced position that it now favors opening up of competition within the local service area.

Pacific Bell, as well as some critics of their plan, believe that such a significant policy change by the largest telephone utility in the state could very well change the very nature of Phase III from one of determining if there should be greater toll competition--to when intraLATA competition will be scheduled to occur.

SECTION III. UTILITY PROPOSALS FOR GREATER COMPETITION

For the past two years both Pacific Bell and GTEC have pursued proposals at the PUC which would provide them with what they consider to be relief from over-regulation in an evermore competitive telecommunications environment. Pacific Bell's plan is called the "Price Stability Plan", and GTE California has called for a "New Regulatory Framework".

A. Pacific Bell Proposal

As a rate proposal submitted to the PUC, and as a plan submitted for the present commission investigation, Pacific Bell has expressed that it believes the existing system of Rate of Return regulation should be scrapped for a system which does the following:

- ° stabilizes residential rates for a specific number of years;
- ° moves more toward "cost of service pricing" by reducing subsidies and targeting them differently;
- ° provides incentives for utilities to cut costs by allowing shareholders and customers to share in the benefits from efficient strategies;
- ° allows for "pricing flexibility" for non-basic services.

The most recent Pacific Bell proposal, however, does not include an additional request made by the utility two years ago. In 1986, Pacific Bell called for:

"CONTINUED INTRALATA FRANCHISE. Continuing the intraLATA franchise for Pacific Bell will help provide for a revenue source and the economies-of-scale required to keep residence prices low.

- ° Reserve provision of intraLATA service to Pacific Bell.
- ° The Company can achieve flat, or lowered toll rates without disruption of the franchise."

○ Last July, Pacific Bell announced what the press reported as "sweeping proposals" to sweeten the offer before the PUC to agree to its rate flexibility plan. Included among these, for the first time, was the offer to puncture the local monopoly telephone service areas by allowing competitors like AT&T, MCI and Sprint to compete for regional toll-call service. In addition, Pacific Bell would make dial-tone service a basic service and install modern digital switch equipment in those rural areas where costs have been prohibited up until now.

Some critics of the Pac Bell proposal have pointed to recent criticism of the utility by DRA concerning "wasteful spending" of ratepayers' money to "overbuild" certain telecommunication projects. They say this demonstrates the need for close regulatory scrutiny of the telephone utility and that possibly it was planning to enhance competitive services at monopoly ratepayer expense.

B. GTE California Proposal

GTE California has been going through dramatic changes, which have included changing its name, personnel cuts, selling off its ownership in SPRINT, and reorganizing its national corporate structure. GTEC has also had an on-going rate case at the commission which finally determined that the utility should cut future telephone rates by more than \$300 million. At the same time the utility has pushed for a new regulatory program which is similar to Pacific Bell's, but differs in the following ways:

- ° instead of freezing rates for residential customers for a period of time, GTEC would allow those rates to be adjusted or "rebalanced" through an indexing approach;.
- ° requests downward and upward pricing flexibility for centrex and custom calling;
- ° opposes changing the ban on intraLATA competition;
- ° different approach to incentive (profit sharing).

The DRA has stated that the proposals in its report submitted to the commission are closer to GTEC's than Pacific Bell's because they call for indexing of local rates for residential users instead of a freeze. GTEC, however, has said the DRA would favor a utility-specific indexing of rates, where it favors a uniform statewide adjustment.

Interested parties to the OII who have commented on the short time lines, have stressed the fact that there are more proposals on regulatory reform than just Pacific Bell's which need close review (i.e. Bay Area Teleport, GTEC etc.). And, before PUC commissioners vote on significant changes, all proposals and witnesses who so desire should be given full opportunity to participate.

GTE CALIFORNIA AND CONSUMERS COALITION OF CALIFORNIA
JOINT AUDIT REPORT - SUMMARY

On January 5, 1987, GTE California Incorporated (GTEC) filed its 1988 Rate Case Application (A.87-01-002). Ms. Virginia Jarrow, President of Consumers Coalition of California (CCC), and Millie Pelton, a member of CCC, filed testimony in GTEC's case. Their testimony identified concerns regarding GTEC's Billing System and the Customer Representative function.

CCC cross-examined several of GTEC's witnesses during the initial days of the rate case hearings. It became clear, however, that this was an inefficient method for developing factual material relevant to CCC's concerns. As reported in Transcript Volume 16 (June 1, 1987), pages 1909 through 1911, GTEC and CCC agreed to conduct an audit of selected areas outside of the evidentiary hearings.

To initiate the audit, an overview meeting was held to provide CCC with a synopsis of the various billing functions and the customer representative activities within the company. Several tours and interviews were conducted at GTEC's facilities so that CCC could observe the billing and customer service functions. Ms. Virginia Jarrow and Mr. Robert Morris (TRW) represented CCC on the tours and interviews.

In addition to tours and interviews, a customer representative survey was administered at the request of CCC. CCC wanted to obtain information on the actual process the customer representatives go through when handling a customer's call. Also at the request of CCC, a tally was taken of all "memos" collected and printed for one day from the Cerritos Customer Billing Center (CBC). A memo is generated onto a customer's account record when the customer calls into the CBC. The purpose of summarizing the memos was to determine the types and quantities of calls which were coming into the CBC.

Test calling was performed in order to validate the billing system and ensure that the billing processes were functioning correctly. Specifically, Ms. Jarrow had indicated that she had a problem in being billed for incomplete one-minute calls. She requested that the test calling be focused on this problem. A one-week tally was taken at the Cerritos Customer Billing Center (CBC) which identified customer's problems and specifically the problem of billing for incomplete one-minute calls. Arrangements were made to conduct test calling with customers who had complained about the incomplete one-minute calls. Members of CCC chose not to participate in the test calling.

Results and Conclusions

GTEC

Test calling was performed on ten customer lines using parameters established in meetings between GTEC and CCC. With one exception, all test calling was performed from the customer's premise. In summary, no billings were generated for any of the IntraLATA Toll or ZUM incomplete test calls. A total of 645 incomplete IntraLATA Toll and ZUM calls were performed during the test calling. In addition, forty percent of the testing was performed during peak traffic hours.

GTEC concluded that the test calling results substantiated that the process which was described in the tours and interviews of GTEC's facilities did not produce any billings for IntraLATA Toll and ZUM calls. In addition to the test calling results, the procedures which are followed from data generation to bill preparation were reviewed and indicated that incomplete calls are not billed.

The results of the customer representative survey indicated that the customer representatives handle most calls to completion. A majority of the representatives refer to GTEC's policies and procedures. The representative did indicate an interest in broader cross-training.

CCC Recommendations and Conclusions

CCC made several recommendations and conclusions, some of which are listed below:

CCC would like to have the Commission make an investigation of one-minute calls and look into the possibility of a universal monitoring system like the Standard Network Interface (SNI) being placed at the residence. CCC also recommended that a device be installed in conjunction with the SNI which could determine the location of problems such as static, moisture and high resistance on the lines.

CCC recommended that each monthly billing complaint be handled as a separate account, eliminating the policy of only one refund in three months. CCC also recommended that refunds be given those customers who complain of intermittent one-minute calls registering in the "early morning test hours."

CCC recommended that an automatic refund policy be implemented for unusual one time occurrences.

CCC recommended that a universal refund policy up to \$15.00 per month be implemented.

CCC recommended that an Arbitration Board be established and made up of consumer advocates active in utility issues.

In addition, CCC made recommendations relative to 611 and 411, however, CCC was not reviewing these functions in this audit. CCC requested and was provided one tour of the 611 Repair Answer Center in Mission Hills.

DECISION

The proposed 3rd Interim decision was issued on November 29, 1988 and included issues identified in the joint audit. The Administrative Law Judge indicated that the record disclosed insufficient support for adoption of any of the recommendations made by CCC.

CONSUMERS COALITION OF CALIFORNIA

EXECUTIVE SUMMARY

OF

THE JOINT AUDIT REPORT OF GENERAL TELEPHONE
AND CONSUMERS COALITION OF CALIFORNIA

ON

TRANSMISSION AND CUSTOMER SERVICE PROBLEMS
OCTOBER 25, 1988, INTERIM HEARING

FOR

THE SENATE COMMITTEE ON
ENERGY AND PUBLIC UTILITIES

#A 1109 Barbara St.
Redondo Beach, California 90277

MEMORANDUM

This audit was prepared jointly with Consumers Coalition of California (CCC) and General Telephone of California (GTEC). Contributors to the report were selected GTEC personnel and CCC consultants, Virginia Jarrow, President of CCC and a Marketing Research Consultant, and Robert Morris, Management Systems Advisor in pricing and cost estimating at TRW.

CCC questioned GTEC's compliance reporting methods used for defining problems in transmission and customer service. Particularly, CCC challenged the practice of separating the handling of the complaints for transmission (611) from customer service. This resulted in a lack of data exchange between the two services and communication problems for the customers. Because of the PUC ordering paragraph 3 in decision D 84-07-108, CCC had a concern that this practice was being encouraged by GTEC statewide to the disadvantage of the consumer. Within this PUC decision; regarding the poor quality of service being provided from specified Central Office's (CO's); GTEC was ordered to collect data on customer trouble reports per 100 lines and dial service indices for these CO's. Based on individual performance, a CO was subject to a surcredit of \$3.80 a line, which was imposed when in two of three consecutive months the customer trouble reports were 10 or more per 100 lines, or the transmission service index was less than 97% for that CO.

The PUC order may have also led to the present GTEC policy of discouraging customers from reporting problems by; giving only 1 credit in a 3 month period; and if the customer persists in reporting problems, referring them to special investigations where line tests are instituted. These tests would occur several months after the initial problem report. They would not be performed on a similar day or at a similar time, but after midnight and would be under conditions controlled by GTEC from the CO's. Furthermore there was a policy of reporting these results to the PUC with "No problem found" (Within the lines).

CCC also examined the billing system and found there were no checks in the system to validate that the billing data was being generated correctly at the CO's. Instead, checks in the system were described as checking lines and loads within CO's and their trunk lines to validate that the CO's were functioning properly and meeting all PUC requirements. Therefore, the management policy for Billing and Customer Services assumed the billing tape was correct and the customer was wrong.

It is our opinion that there is something that occurs in the switching equipment/software that causes incomplete calls to be recorded as completed and then billed. Consequently the volumes that are displayed in the graphs for the 30 and 60 second calls are overstated by the recording of incomplete calls. (Refer to graphs 3.01.1 to 3.03.2 in study). It is highly unlikely that 3 different CO's with 3 different brands of switching systems/equipment/computers/software would generate a volume of activity where 50 % of that volume is 60 seconds or less. It is also doubtful that the one minute percent of total volume for all three CO's would fluctuate in unison. (Graph series 1.04).

One of our current members is a high usage telephone customer, utilizing volume lines and call tracking. In a comparison between his records and the telephone companies records there was a discrepancy in the amount of completed calls. His records for Dec. 4, 1988 thru Jan. 13, 1989 showed 1,378,160 pre-adjusted calls and the phone companies records showed 1,876,113. The difference is an overstatement of completed calls by 497,953, which is 26.54 % of the total call volume. This is similar to the percent displayed on the graph 2.06.2 in the study. This graph shows the sum of 10, 20, and 30 second call volumes percent of total call volume. Note that in the time between 8 am to 5 pm (17) for each day, the 30 second call volume is within 2 to 3 % of our members percentage for uncompleted calls appearing on his bills. How do business and other phone customers validate their phone bills without similar equipment?

MEMORANDUM

Page 3

It is our opinion that the Answer Supervision Standard utilized by telephone companies in California functions correctly 70 % of the time. That the approach and the methodology used to determine that a call has been completed should be revised to achieve 100 % accuracy. Alternately, the phone companies should be required to install/activate a system or methodology that confirms/monitors the switches handling of answer supervision on completed calls. Or, revise all tariffs to make allowance for this error factor.

Because our member does not deal with GTEC, he is under a different tariff. Therefore, our member's record of calls is accepted by his phone company as valid and adjustments are made to the billing. This disparity between tariffs confuses and upsets the average customer. They do not understand why there is not a consistent statewide tariff for telephone companies, or a standard basic customer bill of rights.

Attachment A - References are herein incorporated and made a part of the Summary. (See following page)

ORIGINATING PHONE CALLS ONLY

By Date By Non-Adjusted Variance %

Usage Date		PORT #	BILLED	SBC USAGE	AMOUNT	ADJUSTED FACTOR	VARIANCE	%	Non-ADJUSTED VARIANCE	%
12/13/88		32	34458	27648	30966	12.00%	-3492	-10.13%	-6810	-19.76%
12/13/88		31	40353	31554	35340	12.00%	-5013	-12.42%	-8799	-21.81%
12/13/88		35	32398	25194	28217	12.00%	-4181	-12.91%	-7204	-22.24%
12/13/88		30	37523	29178	32679	12.00%	-4844	-12.91%	-8345	-22.24%
12/13/88	11 & 13		65250	50310	56347	12.00%	-8903	-13.64%	-14940	-22.90%
12/04/88		23	142240	106668	119468	12.00%	-22772	-16.01%	-35572	-25.01%
12/04/88		22	534953	397116	444770	12.00%	-90183	-16.86%	-137837	-25.77%
12/13/88		18	114505	78966	88441	12.00%	-26064	-22.76%	-35539	-31.04%
12/04/88		21	130792	89814	100592	12.00%	-30200	-23.09%	-40978	-31.33%
12/04/88		20	107847	67338	75419	12.00%	-32428	-30.07%	-40509	-37.56%
Usage Total			1240319	903786	1012239	12.00%	-228080	-18.39%	-336533	-27.13%
01/13/89	11 & 13		56656	48072	53841	12.00%	-2815	-4.97%	-8584	-15.15%
01/13/89		31	25520	21450	23794	10.93%	-1726	-6.76%	-4070	-15.95%
01/13/89		35	41187	33564	37692	12.30%	-3495	-8.49%	-7623	-18.51%
01/13/89		32	45841	36696	41099	12.00%	-4742	-10.34%	-9145	-19.95%
01/13/89		30	51890	40452	45306	12.00%	-6584	-12.69%	-11438	-22.04%
01/13/89		18	99738	76854	86076	12.00%	-13662	-13.70%	-22884	-22.94%
01/04/89		23	57955	41728	46735	12.00%	-11220	-19.36%	-16227	-28.00%
01/04/89		20	37500	26174	29315	12.00%	-8185	-21.83%	-11326	-30.20%
01/04/89		21	44248	30329	33968	12.00%	-10280	-23.23%	-13919	-31.46%
01/04/89		22	175259	119055	133341	12.00%	-41918	-23.92%	-56204	-32.07%
Usage Total			635794	474374	531167	11.97%	-104627	-16.46%	-161420	-25.39%
Overall Total			1876113	1378160	1543406	11.99%	-332707	-17.73%	-497953	-26.54%

SUMMARY

On January 5, 1987, General Telephone Company of California (General) filed its 1988 Rate Case Application, 87-01-002. Ms. Virginia Jarrow, president of Consumers Coalition of California (CCC), and Millie Pelton, a member of CCC, filed testimony in General's case. Their testimony identified concerns regarding General's Billing System and the Customer Representative function.

CCC cross-examined several of General's witnesses during the initial days of the rate case hearings. It became clear, however, that this was an inefficient method for developing factual material relevant to CCC's concerns. As reported in Transcript Volume 16, pages 1909 through 1911, General and CCC agreed to conduct an audit of selected areas outside of the evidentiary hearings.

The process followed in completing this audit, as well as the results, have been summarized and included in this report. Several tours and interviews were conducted at General's facilities so that CCC could observe the billing and customer service functions. Ms. Virginia Jarrow and Mr. Robert Morris represented CCC on the tours and interviews. Mr. Morris, Management Systems Advisor for Manufacturing Pricing and Estimating at TRW for seven years, has also done systems design and performed analysis and trouble shooting on various manufacturing and accounting systems for a variety of businesses including electronics manufacturing, mutual funds management, time sharing, wholesale drugs, real estate management, transportation, and food processing.

To initiate the audit, an overview meeting was held to provide CCC with a synopsis of the various billing functions and the customer representative activities within the company. Additionally General spoke briefly regarding employee surveys and interviews and presented the methodology to be utilized in the test calling phase of the study.

The following locations were toured by CCC as part of its investigation:

1. Three Central Offices - Del Amo, Redondo Beach, and Manhattan Beach.
2. The Toll Control Unit at Marina Del Rey.
3. Customer Accounting - Toll Unit at Marina Del Rey and Toll Investigation Unit in Santa Monica.
4. General's Information Management - Systems work group for review of BIS Toll billing software system.
5. GTE Data Services (GTEDS) - Marina Del Rey.
6. The Cerritos Customer Billing Center (CBC).
7. The Repair Answer Center (RAC) - 611 in Mission Hills.
8. The Dispatch and Facilities Administration Center (DAC/FAC) at the South Bay Division Office in Torrance.

General and CCC agreed to study the following :

Review of the flow of information concerning telephone calls from creation of initial data at the telephone switching office to production of the final customer's bill.

Controlled tests of telephone calls to determine whether the billing system accurately charged subscribers for calls made from their phones. Investigation of the recording and billing of short duration calls which appeared on the customer's bill as one-minute calls.

Examination of measuring tools such as the Hekemian device.

Testing of telephone lines to determine whether they accurately connected the customer to the network.

Looking at the service representative function.

CCC also addressed the issues of customer service practices :

1. The policy of a one time refund up to \$35.00
2. The policy of allowing no further adjustments without investigation by GTC's support unit.
3. The practice of denying any further adjustment after investigation.
4. The practice of testing the line to the central office and line from the central office to the residence; a central office inspection on outside facilities with " no trouble found. "
5. The practice of issuing credits and then denying and reversing the credits based on testing valid only at the time the test is taken.
6. The practice of issuing and denying credits based on the Hekemian device test and denying all credits if the customer will not submit to the testing.
7. Service complaints not resolved; i.e., others on the line, cross talk, cannot call out, reached wrong numbers, no dial tone, reached nothing and cutoff during calls.
8. Overcharges for ZUM calls, billings out of sequence and billing twice in the same time frame.
9. One minute calls appearing on billing for different numbers in same 60 second time frame.

10. Excessive one minute call charges.
11. Increasing problem in completing calls during heavy business traffic times.
12. Charges for calls placed to business phones after close of the business day.
13. Charges for incomplete calls on rotary dialing 9726-9727-9728-9729, billing for each number as call is moved forward to the last number, which is the only number answered.
14. Customer Service practice of flagging accounts for no further adjustments, if an adjustment has been made in the previous three months.
15. 611 transmission problems:
 - customer hearing people talk prior to dialing
 - hearing dialing in distance
 - dialing out and getting four-way conversation
 - ringing of phone in background before hanging up on a conversation
 - hanging up and losing dial tone for half a day
 - telephone out of service
 - attempting to hang up and being unable to break the connection resulting in a continuing charge for numbers dialed.

CCC believes that many of the service complaints, charging for one-minute calls without completed answer supervision, failure to make disconnects, incomplete calls that do not ring on the number, failure to release at completion of the calls, cross talk and sending wrong numbers may be inherent in the problem of switching from analog to digital to analog.

With one-minute completed calls representing approximately 46% of ZUM or toll total call volume, the failure of existing equipment to monitor answer supervision in an exact way can greatly and unfairly enrich the telephone company, especially when coupled with the customer service billing policy of giving a one time rebate of up to \$35.00 to a residential user and the policy of discouraging the customer who persists in attempting to have these calls removed, referring him/her to investigation where the account is flagged as a troublemaker.

Transferring Customer Billing Centers (CBC's) and product and costing functions to the Finance Group in the new organizational chart only serves to reinforce the image of General Telephone as a credit collection agency.

CCC requested that Marketing Surveys be performed on Customer Services. In the meeting held on Tuesday, August 25, 1987, between General, CCC and Market Facts, the following requests were made by CCC:

1. A Customer Service questionnaire was to be answered by the Cerritos personnel. The questionnaire was to be received by Market Facts In a sealed envelope and processed.
2. A record extracted from the memos be kept by customer representatives on an ongoing basis. These records were to be divided into categories designated by Market Facts.

The format for the Tally INQUIRY, REQUEST, COMPLAINT was designed in a manner requiring only that the representative check the appropriate box in the 3 categories and write verbatim if desired. The intent of this study was to give exact information to all departments and corporate, also to develop a profile of the customer needs.

The Customer Service questionnaire was given out. The Memos were extracted and summarized by Market Facts. However, In addition to the two studies, CCC would like to see a third study with the customer representatives performing a tally of all calls.

CCC's concern is that the customer representatives do not know how to respond to the real questions of the customer. That they receive little or no instructions in ON-LINE customer handling. That the information needed by the customer is not delivered in a timely manner because the customer representative cannot get this information from the billing tree and other aids and has set company policies to follow. If the service representative is successful in contacting her/his supervisor for information, the rep is referred back to the billing tree and the customer is given the same litany that has not resolved the problem in the past.

On July 13-17, 1987 a study was implemented at the request of CCC which produced the following results. A total of 27,498 calls were answered during this period. 364 accounts were included in the study for one-minute calls and produced 377 complaints. These results indicated that there was a customer base with one-minute call inquiries or complaints. General is not listening.

In the study tallying categories for the week of July 13-17, 1987, CCC indicated that the one-minute call tally conducted recorded a daily volume of approximately 5,500 per day, while the memos extracted for one day were approximately 4,100 memos. Approximately 25% of calls are not recorded and much valuable data is lost. CCC recommends all data be recorded and no judgement selections made as to which data to enter.

In the customer representative survey for one day at the Cerritos CBC the following responses were elicited. THE CUSTOMER REP'S VIEW OF INFORMATION IMPORTANT ENOUGH TO KEEP IN PERMANENT FILES.

1. More bills available to on-line representatives and more pay lines.
2. Paid accounts and actual out orders with important ID information.
3. More info in billing voucher treatment
4. Special TELEMAL file training service reps.
5. TRTMT jargon/slang to other departments so they can relate to follow-up memos.
6. More than two months bills on billing voucher treatment.
7. All updated policy procedures.
8. Returned check history on-line.
9. History of disconnects on-line.
10. History of 611 repairs on-line.

In the area of training that would lead to efficiency, customer representatives described the need for a tracking system for the customer from start to finish of the order, including repair. Need for more training and more knowledge of the Customer Service Center Operations. More videotapes. More discussion. More information about service orders, overview of all functions. Need for insert information coming to the customer representative station before being mailed to the customer.

CCC also recommended that General should go back to its employees with an outside task force having nothing to do with the existing management and interview their employees about resources and working environment.

CCC recommended that a universal refund policy up to \$15.00 per month be implemented. This would create a statewide consistent tariff.

CCC recommended that as one-minute calls represent approximately 50% of total completed call volume and 30 second calls or less represent 80% of these one-minute calls, General should study the feasibility of billing on a 30 second increment instead of billing on one-minute increments.

CCC recommended that a limit be placed on the amount of time customer service is allowed to respond to or make an adjustment to the customer's bill or a refund is granted automatically. CCC suggests this time limit be two billing periods.

CCC recommended that an automatic refund policy be implemented for unusual one time occurrences such as 109 one-minute calls to the same number in one billing period. This should be done to avoid costly testing. 611, Engineering, and Market Research as well as Customer Service should receive memos on these unusual occurrences.

After checking all systems, if no probable cause showed due to lack of exact test duplication of conditions, CCC recommended the customer should be given the benefit of the doubt and given a refund, and this telephone line should be entered on the trouble sheet to be monitored.

During tours of GTEC facilities, testing of the switches was described as checking lines and loads within the CO's and Trunk lines serving that CO. The battery of tests performed proved that the CO was functioning properly and therefore it was assumed that the billing tape was correct. However, testing of new billing/switching software changes were performed at one CO-Switch Type location and then copied to other CO's with the same Switch Type with no further testing performed. Each CO location communicates

with a different set of Switch Types than the testing CO or the other locations. This concept of using a single bench test and validating all other locations at the same time saves money but provides questionable results, ie; Billing Tape's.

During the audit a request was made for a printout of the daily billing tapes for three CO's for a period of seven days. The printout provided the total volume by hour and by duration of call. Call duration was broken out into 10 second intervals up to 60 seconds duration, and then all calls over 60 seconds. This level of detail was required to examine the nature of one-minute calls as it was an area of frequent customer complaints referred to CCC.

The data was collected from three Central Offices for seven days activity covering July 17 through 23. This data included all calls recorded on the daily billing tapes. The Central Offices involved were Del Amo, Redondo, and Manhattan. The Del Amo CO uses a 1EAX switch, which records only completed calls. Redondo uses a GTD5 switch which records completed calls and incomplete Equal Access calls. Manhattan uses a DMS100 switch which records all calls. The data that was given by GTEC for the graphs is for completed calls only.

General does not perform any analysis of the billing tapes for the purpose of identifying problems that may be occurring at a switch. CCC's request for the data was originally intended to see if there was any difference between the switches in recording one-minute calls. This approach changed when the similarities between the switch types appeared more striking than the differences.

There were some surprises in looking at GTC switching data. Roughly 50 percent of all activity on the phone is one-minute or less. Calls of 30 seconds or less were approximately 30 percent of all activity. These calls appeared to reflect the same volume increase/decrease at the same time as the total volume and/or the 31-60 seconds duration calls.

It seemed strange that the activity was so much in harmony. The first impression was that telephone usage should be random activity. Yet the randomness was occurring at the same time within the same call volume showing the same increase and decrease for all types of calls. From an analysis perspective, one could suspect that the system was generating some base of activity common to all calls. Or the system was recording all activity including uncompleted calls. Based on data provided by GTEC out of every 100 calls the average customer will make: 30 will be 30 seconds or less, 20 will be 31-60 seconds. and 50 calls will be over 60 seconds. Comparison of the charging practices of General to the actual behavior on the phone system should be performed to assure that the customer is receiving equitable service for charges paid.

CCC requested that the telephone companies and the switching manufacturers work together to revise the standards statewide to achieve compatibility within the telephone systems. These standards should include the performance of compatibility tests to assure that the customer is not being charged for switching delays in connecting with other systems or time spent in searching for pathways. Customer charging should begin when answer supervision has been completed at the called number and not at the time of the "OFF HOOK" condition before dialing.

CCC asks that the Senate Oversight Committee request the PUC order an investigation of the ESS switching and Billing systems for the entire telecommunications system. The State of California and the California Telecommunications industry have the resources, the skill and the expertise to bring about these improvements and move forward into the Information Age.